# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1938

# No. 385

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## FIRST CHROLD CORPORATION, PETITIONER,

*vs.*

## COMMISSIONER OF INTERNAL REVENUE

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., NOVEMBER 28, 1938.

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# United States Board of Tax Appeals.

DOCKET NO. 81629.

FIRST CHROLD CORPORATION,
*Petitioner,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

Appearances:
For Taxpayer: JOHN E. MCCLURE, ESQ.
For Commissioner: I. M. TULLAR, ESQ.

## DOCKET ENTRIES.

| | |
|---|---|
| Sept. 19, 1935. | Petition received and filed. Taxpayer notified. (Fee paid.) |
| Sept. 20, 1935. | Copy of petition served on General Counsel. |
| Nov. 8, 1935. | Answer filed by General Counsel. |
| Nov. 14, 1935. | Copy of answer served on taxpayer. |
| Mar. 13, 1936. | Motion for circuit hearing at New York City filed by taxpayer. 3/13/36 Granted. |
| Aug. 6, 1937. | Hearing set week beginning Oct. 11, 1937, in New York City. |
| Oct. 15, 1937. | Called on the merits, 10/11/37. Hearing had before Mr. Van Fossan, Div. 9. Submitted. Stipulation of facts and petitioner's brief (served on the respondent) filed at hearing. Respondent's reply brief due 30 days. |

| | |
|---|---|
| Nov. 2, 1937. | Transcript of hearing, Oct. 15, 1937, filed. |
| Nov. 13, 1937. | Reply brief filed by General Counsel. |
| Nov. 18, 1937. | Reply brief filed by taxpayer. 11/19/37 copy served on General Counsel. |
| Nov. 30, 1937. | Memorandum opinion rendered, Mr. Van Fossan, Div. 9. Decision will be entered under Rule 50. |
| Dec. 11, 1937. | Motion for redetermination filed by General Counsel. Consented to by taxpayer. |
| Dec. 11, 1937. | Decision entered—Ernest H. Van Fossan, Div. 9. |
| Jan. 24, 1938. | Petition for review by United States Circuit Court of Appeals, Third Circuit, with assignments of error filed by taxpayer. |
| Jan. 24, 1938. | Proof of service filed by taxpayer. |
| Jan. 24, 1938. | Statement of evidence lodged. |
| Jan. 24, 1938. | Notice of lodgment of statement of evidence and hearing on 2/2/38 filed by taxpayer. |
| Jan. 24, 1938. | Præcipe for record filed by taxpayer —with proof of service thereon. |
| Feb. 2, 1938. | Hearing had before Mr. Van Fossan on settlement of statement of evidence. Respondent has no objections. |
| Feb. 4, 1938. | Statement of evidence approved and ordered filed. |

**PETITION.**

(Filed September 19, 1935.)

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 81629.

FIRST CHROLD CORPORATION,
*Petitioner,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:A-4 GCH-90D), dated July 12, 1935, and as a basis of its proceedings alleges as follows:

I. The petitioner is a corporation with its principal office at 19 Dover Green, Dover, Delaware.

II. The notice of deficiency, a copy of which is attached hereto and marked Exhibit A, was mailed to the petitioner on July 12, 1935.

III. The taxes in controversy are income and excess profits taxes for the year 1933 in the amounts of $4794.05 and $1743.29, respectively.

IV. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) The Commissioner erred in transferring the syndicate profit of $6435.17 from the year 1932 to the year 1933.

(2) The Commissioner erred in adding to income the sum of $27,944.65, representing an al-

leged profit from the sale by the petitioner of its own capital stock.

V. The facts upon which the petitioner relies in support of its appeal are as follows:

*Issue No. 1, Syndicate Profit:*

(a) During 1932, the petitioner participated in certain syndicates, and reported as income for that year its share of the income of such syndicates, although the income was not in fact distributed until 1933.

(b) The amount of such income earned in 1932 and distributed to your petitioner amounted to $6435.17.

(c) The respondent, in determining the deficiency herein, added the said $6435.17 to the petitioner's 1933 income, on the theory that the said syndicates were associations taxable as corporations.

(d) The said $6435.17 was available to your petitioner in 1932 and constituted income to your petitioner for the year 1932.

*Issue No. 2, Profit on Own Stock:*

(a) The petitioner was formed on April 8, 1930, under the laws of Delaware, with an authorized capital stock of 100,000 shares without par value, for the primary purpose of buying and selling stock listed on the New York Stock Exchange.

(b) On August 4, 1932, the stockholders approved a reduction in the authorized capital stock of 100,000 shares of no par value to 10,000 shares of no par value, and the articles of incorporation were accordingly amended.

(c) While the petitioner was authorized to issue 10,000 shares of no par value, it never at any time had issued that number of shares. The maximum number issued at any one time was 5748 shares.

(d) Practically all the stockholders of petitioner were customers of E. F. Hutton & Company; one Gerald M. Loeb, manager of petitioner was a partner of E. F. Hutton & Company during the year in question.

(e) From time to time a few of the stockholders, who were also customers of E. F. Hutton & Company, wanted to retire from the company, for some reason or other. The petitioner was a small corporation and the stock was not listed on any exchange, and there were no outside funds available. Petitioner purchased said stock, such purchase being made usually at one point below the liquidated value of the assets of the petitioner.

(f) From time to time other customers of E. F. Hutton & Company desired to acquire stock of the petitioner, and sales were made to such persons usually at one point above the liquidated value of the assets of petitioner. There is attached hereto, marked Exhibit B, a statement showing the number of shares retired through purchase, the price paid therefor, and the number of shares issued and sold, and the price at which sold, during the years 1931 to 1934, inclusive. During 1933, the petitioner sold to such persons 662 shares at a total selling price of $92,593.05, new certificates being issued at the time to such new shareholders.

(g) The respondent, in determining the deficiency herein, assumed and determined that the shares of stock sold by the petitioner during 1933 for $92,593.05 were acquired by the petitioner during 1931 at a cost of $64,648.40, and added to income the difference of $27,944.65.

(h) Petitioner admits that it did purchase 662 shares in 1931, at a cost of $64,648.40, and further admits that it sold 662 shares during 1933 for the sum

of $92,593.05. Petitioner alleges, however, that the shares of stock sold in 1933 were not purchased by it in 1931; that the shares purchased in 1931 were retired; and that the sales of shares made in 1933 were from unissued stock and were represented by the issuance of new certificates.

(i) Petitioner further alleges that it never dealt in its own stock and that it realized no gain or loss from such transactions, as stated above.

(j) Petitioner further says that if it is the law that the petitioner realized gain or loss in the sale and purchase of its own stock, then such gain or loss occurred during previous years, when the outstanding shares of stock were purchased, in that under the following statement by the Supreme Court in *United States v. Kirby Lumber Company*, 284 U. S. 1:

> "... As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here ...."

gain or loss occurred when petitioner repurchased the certificates of stock below or above the issuing price, and petitioner did not realize any such profit or sustain any such loss during 1933, in that it did not repurchase any of its stock during said year.

WHEREFORE, petitioner prays that this Board may hear the proceeding and determine that the Commissioner erred as alleged above.

(Sgd.) JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.,
*Attorney for Petitioner.*

STATE OF NEW YORK,
COUNTY OF NEW YORK, } ss.:

WALTER D. EBBITT, being duly sworn, says that he is president of the First Chrold Corporation, and as such is duly authorized to verify the foregoing petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be on information and belief, and those facts he believes to be true.

(Sgd.) WALTER D. EBBITT.

Subscribed and sworn to before me this seventeenth day of September, 1935.

(Sgd.) ALBERT T. DICKERSON,
(Seal) *Notary Public.*
My commission expires March, 1937.

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EXHIBIT A.

IT:AR:A-4
GCH-90D

JUL 12 1935

First Chrold Corporation,
61 Broadway,
New York, New York.

Sirs:

You are advised that the determination of your tax liability for the year 1933, discloses a deficiency in income tax of $4,794.05 and excess profits tax of $1,743.29, as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not count-

ing Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By (Signed) CHAS. T. RUSSELL
Deputy Commissioner.

Enclosures:
Statement.
Form 870.

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STATEMENT.

IT:AR:A-4
GCH-90D

In re: First Chrold Corporation,
61 Broadway,
New York, New York.

Tax Liability for Taxable Year 1933

| | Liability | Assessed | Deficiency |
|---|---|---|---|
| Income Tax | $24,562.60 | $19,768.55 | $4,794.05 |
| Excess profits tax | 2,056.85 | 313.56 | 1,743.29 |

The deficiency shown herein is based upon the report dated September 22, 1934 prepared by Revenue Agent Henry Bender, a copy of which was transmitted to you.

Careful consideration has been accorded your protest dated February 25, 1935, in connection with findings of the examining officer and the information submitted at a conference held in this office on July 9, 1935.

The overassessment of $452.80 for the year 1932 recommended in the above-mentioned report cannot be allowed due to the fact that in accordance with the provisions of section 322 of the Revenue Act of 1932 "no such credit or refund shall be allowed or made after two years from the time the tax was paid unless before the expiration of such period a claim therefor is filed by the taxpayer." The records of this office indicate that the total tax liability for the year 1932 was paid on March 16, 1933 and that no claim for refund was filed by you prior to March 15, 1935.

1933

| | | |
|---|---|---|
| Net income shown on return | | $143,771.25 |
| Add: | | |
| (1) Insurance premiums | $486.00 | |
| (2) Profit from sale of corporation's own stock | 27,944.65 | |
| (3) Syndicate profit | 6,435.17 | |
| | | 34,865.82 |
| Adjusted net income | | $178,637.07 |

**Explanation of Changes.**

(1) Insurance premiums paid on lives of officers where corporation is the beneficiary is not an allowable deduction.

(2) Profit realized on sale of own stock is as follows:

| | |
|---|---|
| Received from sale of 662 shares | $92,593.05 |
| Adjusted cost | 64,648.40 |
| Taxable net profit realized | $27,944.65 |

(3) Net profits from syndicates in 1933 have been adjusted as follow:

| | | |
|---|---|---|
| Joint accounts | | $84,424.80 |
| Received from Novadel Trading Account | $13,850.56 | |
| Reported | 8,390.77 | |
| | | 5,459.79 |
| Received from General American Tank Car Trading Account | $ 254.29 | |
| Reported | 24.38 | |
| | | 229.91 |
| Received from American Com'l. Alcohol Trading Account | $ 834.55 | |
| Reported | 89.08 | |
| | | 745.47 |
| Total amount received | | $ 90,859.97 |
| Amount reported on return | | 84,424.80 |
| Additional income | | $ 6,435.17 |

Computation of Tax.

| | |
|---|---|
| Net income, taxable at 13¾% | $178,637.07 |
| Tax at 13¾% | 24,562.60 |
| Tax previously assessed | 19,768.55 |
| Deficiency | $ 4,794.05 |

**Excess Profits Tax.**

| | |
|---|---|
| Net income | $178,637.07 |
| Less: | |
| 12½% of $1,100,000.00 value of capital stock as declared in capital stock tax return ended June 30, 1933 | 137,500.00 |
| Balance subject to excess profits tax at 5% | $ 41,137.07 |
| Excess profits tax at 5% | 2,056.85 |
| Tax previously assessed | 313.56 |
| Deficiency | $ 1,743.29 |

Your return for the taxable year 1934, disclosing no tax liability has been accepted as filed.

A copy of this letter together with a copy of the statement and schedules has been mailed to your representative Miller and Chevalier, Southern Building, Washington, D. C., in accordance with the authority conferred upon him in the power of attorney executed by you and on file with the Bureau.

## EXHIBIT B.

### PURCHASES AND SALES BY THE CORPORATION OF ITS OWN STOCK.

| 1931 | Purchases | | | 1931 | Sales | | |
|---|---|---|---|---|---|---|---|
| Date | Shs. | Price | Cost | Date | Shs. | Price | Proceeds |
| Feb. 16 | 60 | 114 | $ 6,855.00 | Feb. 20 | 25 | 114⅝ | $ 2,858.38 |
| Mar. 30 | 100 | 111 | 11,125.00 | Feb. 24 | 35 | 116 | 4,049.85 |
| Apr. 14 | 50 | 111½ | 5,562.50 | Mar. 31 | 50 | 113 | 5,635.00 |
| Apr. 20 | 100 Cash | 110 | 11,025.00 | Apr. 2 | 10 | 113 | 1,126.60 |
| May 6 | 50 | 108 | 5,412.50 | Apr. 16 | 90 | 111¼ | 10,031.40 |
| Aug. 4 | 100 | 100¾ | 10,100.00 | | 210 shs. | | |
| Aug. 26 | 50 | 96 | 4,810.00 | | | | |
| Aug. 27 | 50 | 96 | 4,810.00 | | | | |
| Sept. 21 | 136 | 96 | 13,083.20 | | | | |
| Sept. 30 | 50 | 98 | 4,910.00 | | | | |
| Oct. 6 | 250 Cash | 98 | 24,550.00 | | | | |
| Oct. 6 | 150 Cash | 98 | 14,730.00 | | | | |
| Oct. 8 | 150 Cash | 98 | 14,730.00 | | | | |
| Oct. 21 | 50 | 98 | 4,910.00 | | | | |
| Oct. 26 | 10 | 98 | 983.00 | | | | |
| Nov. 10 | 250 Cash | 100 | 25,062.50 | | | | |
| Nov. 13 | 50 | 100 | 5,012.50 | | | | |
| Dec. 10 | 25 Cash | 103¾ | 2,600.00 | | | | |
| Dec. 11 | 5 | 102 | 513.00 | | | | |
| | 1,686 shs. | | | | | | |

| | |
|---|---|
| Total Purchases | 1,686 shares |
| Less Total Sales | 210 " |
| Shs. held at end of 1931 | 1,476 " |

| 1932 | | | | 1932 | | | |
|---|---|---|---|---|---|---|---|
| Feb. 29 | 146 | 105½ | $15,439.00 | Jan. 12 | 10 | 106¾ | $ 1,064.10 |
| May 11 | 24 | 105¼ | 2,532.00 | Dec. 7 | 200 | 118.98 | 23,728.00 |
| May 19 | 450 | 102 | 46,012.50 | | | | |
| June 21 | 10 | 108 | 1,083.00 | | | | |
| July 5 | 10 | 108 | 1,083.00 | | | | |
| | 640 shs. | | | | | | |

| | |
|---|---|
| Total Purchases | 640 shares |
| Less Total Sales | 210 " |
| | 430 " |

| | |
|---|---|
| Balance at end of 1931 | 1,476 shares |
| Plus purchases in 1932 | 640 " |
| | 2,116 " |
| Less sales in 1932 | 210 " |
| Balance at end of 1932 | 1,906 " |

1933

| Purchases | | | |
|---|---|---|---|
| Date | Shs. | Price | Cost |

1933

| Sales | | | |
|---|---|---|---|
| Date | Shs. | Price | Proceeds |
| Feb. 23 | 20 | 117 | $ 2,333.20 |
| May 3 | 5 | 132 | 656.55 |
| May 5 | 25 | 133½ | 3,329.00 |
| May 8 | 50 | 133½ | 6,658.00 |
| May 9 | 40 | 134 | 5,346.00 |
| May 11 | 25 | 131⅜ | 3,288.38 |
| May 15 | 25 | 131 | 3,266.50 |
| May 22 | 40 | 129 | 5,146.40 |
| June 9 | 10 | 142 | 1,416.10 |
| June 9 | 50 | 142 | 7,083.00 |
| June 9 | 25 | 144 | 3,591.50 |
| July 12 | 50 | 146 | 7,283.00 |
| Aug. 31 | 65 | 146 | 9,467.90 |
| Sept. 1 | 3 | 146¾ | 436.98 |
| Sept. 6 | 2 | 145½ | 287.82 |
| Sept. 18 | 10 | 150¼ | 1,498.60 |
| Sept. 26 | 100 | 145 | 14,466.00 |
| Oct. 25 | 4 | 147 | 584.64 |
| Nov. 21 | 86 | 146 | 12,526.76 |
| Dec. 4 | 17 | 143 | 2,425.22 |
| Dec. 19 | 10 | 150½ | 1,501.10 |
| Total | 662 Shs. Sold | | |

| | |
|---|---|
| Balance at end of 1932 | 1,906 shares |
| Less Sales in 1933 | 662 " |
| Balance at end of 1933 | 1,244 " |

1934

1934

| | | | |
|---|---|---|---|
| Jan. 16 | 50 | 148⅝ | $ 7,414.25 |
| Feb. 15 | 100 | 139¾ | 13,941.00 |
| Feb. 21 | 100 | 142 | 14,166.00 |
| Total | 250 Shs. Sold | | |

| | |
|---|---|
| Balance at end of 1933 | 1,244 shares |
| Less Sales in 1934 | 250 " |
| Balance, 1934 | 994 " |

## ANSWER.

(Filed November 8, 1935.)

COMES now the Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, assistant general counsel for the Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

I-II-III. Admits the allegations in paragraphs I, II and II of the petition.

IV. Denies the allegations of error in paragraph IV of the petition.

V. *Issue No. 1, Syndicate Profit.*

(a) Admits that petitioner participated in certain syndicates during 1932; that it reported profits from syndicates for 1932; and that part of said income was not distributed until 1933; but denies the remaining allegations in subparagraph (a), Issue No. 1, paragraph V of the petition.

(b) Admits that the amount of such income distributed to petitioner during 1933 was $6435.17, but denies the remaining allegations in subparagraph (b), Issue No. 1, paragraph V of the petition.

(c) Admits the allegations in subparagraph (c), Issue No. 1, paragraph V of the petition.

(d) Denies the allegations in subparagraph (d), Issue No. 1, paragraph V of the petition.

V. *Issue No. 2. Profit on Own Stock.*

(a)-(b)-(c)-(d). For lack of full and complete information, denies the allegations in subparagraphs (a), (b), (c), and (d), Issue No. 2, paragraph V of the petition.

(e) Admits that petitioner purchased from time to time, the stock of its stockholders, but denies the remaining allegations in subparagraph (e), Issue No. 2, paragraph V of the petition.

(f) Admits that petitioner sold 662 shares of its capital stock during 1933 for a total of $92,593.05, but denies the remaining allegations in subparagraph (f), Issue No. 2, paragraph V of the petition.

(g) Admits the allegations in subparagraph (g), Issue No. 2, paragraph V of the petition.

(h) Admits that petitioner purchased 662 shares of its stock during 1931 for $64,648.40, and that it sold 662 shares during 1933 for the sum of $92,593.05; but denies the remaining allegations in subparagraph (h), Issue No. 2, paragraph V of the petition.

(i)-(j). Denies the allegations in subparagraphs (i) and (j), Issue No. 2, paragraph V of the petition.

Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Signed) ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue.*

Of Counsel:
HUGH BREWSTER,
*Special Attorney,*
*Bureau of Internal Revenue.*

HB/vn 11-7-35

**MEMORANDUM OPIONION.**

(Rendered November 30, 1937.)

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 81629.

*First Chrold Corporation,*
Petitioner,

v.

*Commissioner of Internal Revenue,*
Respondent.

*John E. McClure, Esq.*, for the petitioner.
*I. M. Tullar, Esq.*, for the respondent.

VAN FOSSAN: These proceedings were brought to redetermine deficiencies in income and excess profits taxes of the petitioner for the year 1933 in the sums of $4,794.05 and $1,743.29, respectively.

The sole issue in the case is whether the petitioner dealt in its own shares of stock as it might in the shares of another corporation or, in other words, whether the petitioner, by purchasing shares of its own stock and later selling them, realized a taxable gain.

The pleadings established a second issue relating to the proper year for correctly reporting syndicate profit. The parties agree by stipulation that this syndicate profit was correctly reported as income in 1932 and that the respondent was in error in including the profit therefrom as income in 1933.

The facts, which, for the most part, were stipulated, are as follows:

The petitioner is a Delaware corporation organized April 8, 1930, for the purpose of speculating in listed

stocks. In the course of its business the petitioner never owned stocks that were not listed on the Exchange. During the taxable year the petitioner had authorized capital stock of 10,000 shares of which 5,749 were issued at approximately $100 per share.

Mr. Gerald M. Loeb, a partner of E. F. Hutton & Co. of New York City, managed the petitioner from the time of its organization through the taxable year. The original subscribers for the petitioner's stock were some 60 or 70 friends of Mr. Loeb, who were promised at the time the stock was issued that the corporation would repurchase the stock if they wished to sell it, and if financial conditions permitted. The stock of the petitioner was not listed on any stock exchange.

The petitioner made the following purchases and sales of its own stock during the period from 1931 to 1933, inclusive:

| 1931 | PURCHASES | | | 1931 | SALES | | |
|---|---|---|---|---|---|---|---|
| Date | Shs. | Price | Cost | Date | Shs. | Price | Proceeds |
| Feb. 16 | 60 | 114 | $ 6,855.00 | Feb. 20 | 25 | 114⅝ | $ 2,858.38 |
| Mar. 30 | 100 | 111¼ | 11,125.00 | Feb. 24 | 35 | 116 | 4,049.85 |
| Apr. 14 | 50 | 111¼ | 5,562.50 | Mar. 31 | 50 | 113 | 5,635.00 |
| Apr. 20 | 100 Cash | 110 | 11,025.00 | Apr. 2 | 10 | 113 | 1,126.60 |
| May 6 | 50 | 108 | 5,412.50 | Apr. 16 | 90 | 111¼ | 10,031.40 |
| Aug. 4 | 100 | 100¾ | 10,100.00 | | 210 shs. | | |
| Aug. 26 | 50 | 96 | 4,810.00 | | | | |
| Aug. 27 | 50 | 96 | 4,810.00 | | | | |
| Sept. 21 | 136 | 96 | 13,083.20 | | | | |
| Sept. 30 | 50 | 98 | 4,910.00 | | | | |
| Oct. 6 | 250 Cash | 98 | 24,550.00 | | | | |
| Oct. 6 | 150 Cash | 98 | 14,730.00 | | | | |
| Oct. 8 | 150 Cash | 98 | 14,730.00 | | | | |
| Oct. 21 | 50 | 98 | 4,910.00 | | | | |
| Oct. 26 | 10 | 98 | 983.00 | | | | |
| Nov. 10 | 250 Cash | 100 | 25,062.50 | | | | |
| Nov. 13 | 50 | 100 | 5,012.50 | | | | |
| Dec. 10 | 25 Cash | 103¾ | 2,600.00 | | | | |
| Dec. 11 | 5 | 102 | 513.00 | | | | |
| | 1,686 shs. | | | | | | |

| | |
|---|---|
| Total Purchases | 1,686 shares |
| Less Total Sales | 210 " |
| Shs. held at end of 1931 | 1,476 " |

| 1932 | | | | 1932 | | | |
|---|---|---|---|---|---|---|---|
| Feb. 29 | 146 | 105½ | $15,439.00 | Jan. 12 | 10 | 106¼ | $ 1,064.10 |
| May 11 | 24 | 105¼ | 2,532.00 | Dec. 7 | 200 | 118.98 | 23,728.00 |
| May 19 | 450 | 102 | 46,012.50 | | | | |
| June 21 | 10 | 108 | 1,083.00 | | | | |
| July 5 | 10 | 108 | 1,083.00 | | | | |
| | 640 shs. | | | | | | |

| | |
|---|---|
| Total Purchases | 640 shares |
| Less Total Sales | 210 " |
| | 430 " |

| | |
|---|---|
| Balance at end of 1931 | 1,476 shares |
| Plus purchases in 1932 | 640 " |
| | 2,116 " |
| Less sales in 1932 | 210 " |
| Balance at end of 1932 | 1,906 " |

1933

| Purchases | | | |
|---|---|---|---|
| Date | Shs. | Price | Cost |

1933

| Sales | | | |
|---|---|---|---|
| Date | Shs. | Price | Proceeds |
| Feb. 23 | 20 | 117 | $ 2,333.20 |
| May 3 | 5 | 132 | 656.55 |
| May 5 | 25 | 133½ | 3,329.00 |
| May 8 | 50 | 133½ | 6,658.00 |
| May 9 | 40 | 134 | 5,346.00 |
| May 11 | 25 | 131⅜ | 3,288.38 |
| May 15 | 25 | 131 | 3,266.50 |
| May 22 | 40 | 129 | 5,146.40 |
| June 9 | 10 | 142 | 1,416.10 |
| June 9 | 50 | 142 | 7,083.00 |
| June 9 | 25 | 144 | 3,591.50 |
| July 12 | 50 | 146 | 7,283.00 |
| Aug. 31 | 65 | 146 | 9,467.90 |
| Sept. 1 | 3 | 146¾ | 436.98 |
| Sept. 6 | 2 | 145½ | 287.82 |
| Sept. 18 | 10 | 150¼ | 1,498.60 |
| Sept. 26 | 100 | 145 | 14,466.00 |
| Oct. 25 | 4 | 147 | 584.64 |
| Nov. 21 | 86 | 146 | 12,526.76 |
| Dec. 4 | 17 | 143 | 2,425.22 |
| Dec. 19 | 10 | 150½ | 1,501.10 |
| Total | 662 Shs. Sold | | |

| | |
|---|---|
| Balance at end of 1932 | 1,906 shares |
| Less Sales in 1933 | 662 " |
| Balance at end of 1933 | 1,244 " |

It will be noted that the petitioner, during 1933, sold 662 shares of its own capital stock at a total selling price of $92,593.05. The respondent, in determining the deficiencies asserted determined that these 662 shares of stock sold by the petitioner during 1933 for $92,593.05 were acquired by the petitioner during 1931 at a cost of $64,648.40 and accordingly added to income the difference of $27,944.65. The petitioner admits that it did purchase 662 shares of its own capital stock in 1931 and sold the same number of shares in 1933, for the sums above mentioned. The purchases and sales of the stock were made on the basis of liquidating value, plus or minus a marginal difference to take care of inaccuracies.

When the petitioner purchased the shares of its own stock they were charged to an account designated "Treasury Stock" in the amounts paid therefor, and they were carried as such on the liability side as a deduction from issued capital. Upon subsequent sales of shares of the stock this account was credited with the cost of the respective shares sold, and the excess of the amount received upon the sale of shares over the price at which an equal number of shares were purchased was credited to an account designated "Surplus From Sale of Treasury Stock". No adjustment was made in the outstanding capital stock by reason of such purchases and sales, the matter being handled entirely by an increase or decrease in the treasury stock. Purchases of stock or securities other than shares of its own capital stock were carried in separate accounts designated "Speculative Long Position in Market" and "Investment Long Position in Market".

The question presented under the applicable statute [1] and regulations [2] is whether the petitioner was dealing in its own shares as it might in the shares of another corporation.

The petitioner denies that it was dealing in its own shares as it might in the shares of another corporation and argues in the alternative that if it did realize any profit from buying and selling its own stock the profit arose, not when the petitioner sold the treasury stock in 1933 but in 1931 when it bought the stock. *Commissioner v. Woods Machine Co.*, 57 Fed. (2d) 635 (1st C. C. A.) to the effect that the real nature of the transaction controls, and *United States v. Kirby Lumber Co.*, 284 U. S. 1, are relied upon to support this latter contention.

We are of the opinion, however, that neither of the positions taken by the petitioner is tenable.

The decision of the Board in *R. J. Reynolds Tobacco Co.*, 35 B. T. A. 494, governs the present case.

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[1] Section 22 of the Revenue Act of 1932.

GROSS INCOME.

(a) *General Definition*—"Gross income" includes gains, profits and income derived from . . . sales, or dealings in property, . . . the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . .

[2] Regulations 77, Article 66, as amended by T. D. 4430.

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

The Board there held the Regulations to be reasonable and consistent with the statute, and further held that notwithstanding the fact that the purchases and sales of its own stock by the Reynolds Company were grounded on business policy, such transactions were taxable ones from which gain or loss might result. The criterion established is whether the transaction is a capital one. See *Commissioner v. Woods Machine Co., supra.*

It is urged by petitioner that the separation of its treasury stock from its regular investment stocks on its books proves that it did not treat its own stock as an investment. Denominate it or treat it as you will, the fact remains that the corporation realized income from the purchase and resale of its stock. (*R. J. Reynolds Tobacco Co., supra.*) No adjustment was made in the outstanding capital stock of the corporation by reason of the transactions.

An attempt is made to distinguish the *R. J. Reynolds Tobacco Co.* case from the present one on the basis that there the magnitude of the transactions clearly indicated their nature. We do not believe this to be significant.

The alternative position taken by the petitioner falls with the assumption that there is no difference so far as gain or loss is concerned between the case where a corporation issues its own bonds and buys them back as in *United States v. Kirby Lumber Co., supra,* and the case where it issues its own stock and then buys it back. Concededly, the original issue of the petitioner's stock was a capital transaction but once stock was sold there was no obligation on the part of the corporation to pay the holder thereof a specific sum as there would be in the case of a bond. The value of a corporation's stock may fluctuate. When a corporation purchases its own bonds at less than the price

at which they were issued it decreases its outstanding fixed obligations. The same result does not obtain when a corporation buys its own stock at a price less than that at which it was issued.

The petitioner's argument that it is not within the pertinent statute and regulations because it did not want to buy its own stock but was motivated by a prior promise to repurchase it, has heretofore been rejected by the Board. *E. R. Squibb & Sons,* 36 B. T. A. 260.

*Decision will be entered under Rule 50.*

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## DECISION.

(Entered December 11, 1937.)

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On November 30, 1937, the Board entered its memorandum opinion in the above-entitled proceeding and on December 11, 1937, respondent filed a proposed recomputation of tax, in which petitioner acquiesced. Wherefore, it is

ORDERED and DECIDED: That there is a deficiency in income tax for the year 1933 in the amount of $3909.21; and there is a deficiency in excess profits tax for the year 1933 in the amount of $1421.54.

(Sgd.) ERNEST H. VAN FOSSAN,
*Member.*

## PETITION FOR REVIEW.

(Filed January 24, 1938.)

IN THE UNITED STATES CIRCUIT COURT OF APPEALS,
FOR THE THIRD CIRCUIT.

B. T. A. Docket No. 81629.

*First Chrold Corporation,*
Petitioner,

v.

*Commissioner of Internal Revenue,*
Respondent.

*To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:*

Now comes First Chrold Corporation, by its attorney, John E. McClure, and petitions this Honorable Court for a review of the decision of the United States Board of Tax Appeals entered on December 11, 1937, redetermining a deficiency in the petitioner's federal income and excess profits taxes for the year 1933 in the amounts of $3909.21 and $1421.54, respectively, and respectfully shows:

I.

First Chrold Corporation is a Delaware Corporation with its principal office at 19 Dover Green, Dover, Delaware. Its returns were filed with the Collector of Internal Revenue for the District of Delaware. This review is sought in the United States Circuit Court of Appeals for the Third Circuit, and Guy T. Helvering, the duly appointed Commissioner of Internal Revenue, is made respondent hereto.

## II.

## NATURE OF CONTROVERSY.

The controversy involves the amount of deficiency, if any, in federal income and excess profits taxes due from the petitioner for the year 1933. This involves a determination (a) whether petitioner realized gain in buying and selling its own capital stock, and if so, then (b) whether the gain arose in 1931 when the petitioner bought its outstanding capital stock or in 1933 when the stock was resold.

The petitioner was organized on April 8, 1930, for the purpose of dealing in stocks listed on the New York Stock Exchange.

At the time the corporation was formed it promised its stockholders that if they wanted to withdraw from the company for any reason, the corporation would take their stock off their hands at one point below the liquidating value of the stock.

During the break in the market in 1931 and 1932 the petitioner, pursuant to its promise to its stockholders, purchased from them 2326 shares of its own stock as against 420 sold. During 1933, when market conditions were somewhat better, it sold 662 shares as against none repurchased. The petitioner, in filing its return, reported no gain or loss from buying and selling its own stock and the regulations of the Commissioner of Internal Revenue at that time were to the effect that a corporation realized no gain nor sustained any loss from dealing in its own stock. Thereafter the respondent issued a formal notice of deficiency and determined that the petitioner had realized a profit of $27,944.65 on the basis that during 1931 the petitioner had acquired 662 shares of common for $64,648.40 and had sold those shares in 1933 for $92,593.05. The taxpayer appealed to the Board of Tax Appeals, claiming that it realized no gain in buying and selling its own

stock, but even if it had realized a gain the same was realized in 1931 when it repurchased the stock and not in 1933. The Board affirmed the Commissioner's determination.

III.

The petitioner believes, and so believing, avers that errors were committed by the Board to the petitioner's damage and prejudice as shown by the following:

(1) There is no evidence to support the holding that the petitioner was dealing in its own shares of stock.

(2) The Board erred in holding that the petitioner realized a taxable profit in 1933 in buying and selling its own stock.

(3) If, as a matter of law, the petitioner was dealing in its own stock, then the Board erred in not holding that the profit, if any, was realized in 1931 when petitioner repurchased its stock and not in 1933 when the stock was resold.

WHEREFORE, your petitioner prays that the decision of the Board of Tax Appeals entered against it be reviewed and reversed by this Court and for such further relief as the Court may deem proper in the premises.

(Sgd.) JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.,
*Attorney for Petitioner.*

CITY OF WASHINGTON,
DISTRICT OF COLUMBIA, } *ss.:*

JOHN E. MCCLURE, being duly sworn, deposes and says that he is the attorney for the petitioner; that he knows the contents of the foregoing petition; that to the best of his knowledge and belief the statements therein are true; and that the assignments of error are well taken and will be argued.

(Sgd.) JOHN E. MCCLURE.

Subscribed and sworn to before me this twenty-fourth day of January, 1938.

(Sgd.) BELLE FOUCAULT,
*Notary Public, D. C.*
My commission expires October 1, 1939.

## NOTICE OF FILING PETITION FOR REVIEW.

(Filed January 24, 1938.)

*To Honorable J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, Washington, D. C.*

Sir:

You are hereby notified that First Chrold Corporation did on the twenty-fourth day of January, 1938, file with the Clerk of the United States Board of Tax Appeals, Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Third Circuit of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this twenty-fourth day of January, 1938.

(Sgd.) JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.,
*Counsel for Petitioner.*

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Personal service of the above and foregoing notice together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this twenty-fourth day of January, 1938.

J. P. WENCHEL,
*Attorney for Respondent.*

## STATEMENT OF EVIDENCE.

(Filed February 4, 1938.)

The statements contained in the memorandum opinion entered on November 30, 1937, in the above-entitled proceeding contain all the evidence adduced at the hearing before the Board of Tax Appeals material to the issues raised in the petition for review; and the same are adopted by reference as a statement of evidence.

(Sgd.) JOHN E. MCCLURE,
*Counsel for Petitioner on Review.*

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I HEREBY CERTIFY that the memorandum opinion entered November 30, 1937, contains all the evidence material to the issues raised in the petition for review, and the same is approved this fourth day of February, 1938.

(Sgd.) ERNEST H. VAN FOSSAN,
*Member, United States Board of Tax Appeals.*

## PRÆCIPE FOR RECORD.

(Filed January 24, 1938.)

*To the Clerk of the United States Board of Tax Appeals:*

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Third Circuit, copies duly certified as correct of the following:

(1) Docket entries of the proceedings before the Board.

(2) Pleadings before the Board.

(3) Opinion and decision of the Board.

(4) Petition for review, together with proof of service of notice of filing petition for review and proof of service of copy of petition for review.

(5) Statement of evidence as settled and allowed.

(6) This præcipe.

(Sgd.) JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.,
*Counsel for Petitioner.*

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Service of a copy of the within præcipe is hereby acknowledged this twenty-fourth day of January, 1938.

J. P. WENCHEL,
*Counsel for Respondent.*

## CLERK'S CERTIFICATE.

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 81629.

*First Chrold Corporation,*
Petitioner,

v.

*Commissioner of Internal Revenue,*
Respondent.

I, B. D. GAMBLE, Clerk of the United States Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 34, inclusive, contain and are a true copy of the transcript of record, papers and proceedings on file and of record in my office as called for by the præcipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this eighth day of February, 1938.

B. D. GAMBLE,
*Clerk, United States Board of Tax Appeals.*

(Seal)

[fol. 32] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, MARCH TERM, 1938

No. 6696

FIRST CHBOLD CORPORATION, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

And now, to-wit: this 7th day of April A. D. 1938, it is ordered that Hon. Oliver B. Dickinson, District Judge for the Eastern District of Pennsylvania, and Hon. —— ——, District Judge for the — District of —, be and he is hereby assigned to sit in above case in order to make a full court.

Joseph Buffington, Circuit Judge.

Endorsements: Order Assigning Judge Dickinson for Argument. Received & Filed Apr. 7, 1938. Wm. P. Rowland, Clerk.

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[fol. 33] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, MARCH TERM, 1938

No. 6696

FIRST CHBOLD CORP., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

And afterwards, to wit, the 7th day of April, 1938, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Joseph Buffington and Honorable John Biggs, Jr., Circuit Judges, and Honorable Oliver B. Dickinson, District Judge, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 26th day of May, 1938, come the parties aforesaid by their counsel aforesaid, and

the Court, now being fully advised in the premises, renders the following decision:

[fol. 34] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, MARCH TERM, 1938

No. 6696

FIRST CHEROLD CORPORATION, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petition for Review from the United States Board of Tax Appeals

OPINION—Filed May 26, 1938

Before Buffington and Biggs, Circuit Judges, and Dickinson, District Judge

DICKINSON, District Judge:

This is an income and excess profits tax case. The taxpayer corporation bought of some of its stockholders shares of stock paying therefor less than its par value. It later sold the stock at a higher price. Was the difference between the selling and purchase price taxable income? The taxpayer thought not and excluded this sum from its taxable income return. The Commissioner thought otherwise, and served the taxpayer with a deficiency notice. The taxpayer appealed to the Board of Tax Appeals, which upheld the Com-[fol. 35] missioner. The taxpayer has asked for this review of the ruling of the Board.

We treat the case as presenting but one question. A corporation which purchases shares of its own stock for less than the sum for which it was issued and then retires the stock may have been advantaged by the transaction in a sense but the real gain is by its remaining stockholders and not by the corporation as such. The change affected is merely a change in the capital structure. The Treasury Regulations so stated and the Courts have so ruled.

Eisner v. Macomber, 252 U. S., 189.

A corporation, however, if so authorized by law, may make the stock of other corporations the subject of purchase and sale precisely as in the case of any other form of property. Any gain from such a transaction is clearly taxable income. A corporation may in fact thus buy and sell its own stock. The gain, if any, is as much a gain as if the transaction was in property other than its own stock. The corporation receives this profit. Its capital structure is not affected. Whether transactions by a corporation in its own stock is a capital or income transaction thus depends upon what the transaction was. The amended Regulations recognize this distinction.

The answer of which we are in search to the question presented, may be made to turn on the nature of shares in the capital stock of a corporation. They are what the word "shares" implies. The relation of corporation and shareholder is not the relation of debtor and creditor otherwise perhaps than in a secondary and remote sense. It is not easy to get in theory the concept of a corporation owning a share of itself and is perhaps not possible. Corporate shares are however easily thought of as property which may be [fol. 36] bought and sold as are other kinds of property. A corporation may in a practical sense so deal in its own stock. When it does, the fact that it is its own stock, is ignored. We know this because corporations do so deal in their own stocks by buying and selling as they buy and sell other property, and this corporation did that very thing here. We are unable to accept the proposition that what it did in fact may be by the use of mental gymnastics turned into the theory that it was not buying and selling its stock as property but when it purchased was reducing the total sum of its capital stock and when it sold expanding its capital. A fairly good test of whether a gain is an income gain or a capital gain is whether it is distributable in dividends payable out of profits. This corporation bought shares of its stock at a price and sold it at a higher price. It in fact had taken in more than it had paid out and had the gain in hand. This was, considered of itself properly distributable in dividends payable out of profits.

The answer to the question presented depends upon whether it is made to turn upon a theory or a fact. In theory a corporation cannot own a share in itself. When it purchases shares in itself, it thereby reduces its capital. When it re-

issues the stock it increases its capital. The transaction is a capital transaction. In fact corporations do buy and sell their own corporate shares, as they buy and sell other forms of property, ignoring, as we have said, the fact that the shares are their own. These are "as if" transactions. The shares are bought and sold as if they were not the corporation's own shares. The capital of the corporation is not affected and the transactions are not capital transactions. If the subjects of purchase and sale were, as is assumed, not the corporation's own shares, the gain, if any, would be an income gain.

[fol. 37] The real question thus becomes one of what the transaction in truth was? Here it was one of the purchase and sale of property. It must of course be admitted that when a corporation has a debt obligation which it acquires by purchase from the holder, its gain, if any, is in its relief from a part of its debt. Here there was an understanding, which may be characterized as a gentleman's agreement, that the corporation would take off the hands of dissatisfied subscribers to its stock, their holdings. The corporation lived up to the spirit of this understanding. It was however not an agreement enforceable by law. The shares purchased by the corporation were bought in fulfilment of this understanding. The promise to purchase merely supplied the motive for the purchase. There was no debt obligation in the sense of a legal obligation.

The petition for a review of the decision of the Board of Tax Appeals is denied, and the ruling of the Board affirmed, with costs to the respondent.

A true Copy. Teste:

——, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 38] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, MARCH TERM, 1938

No. 6696

FIRST CHEROLD CORP., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby affirmed.

Philadelphia, May 26, 1938.

Per Curiam, Buffington, Circuit Judge.

Endorsements: Order Affirming Decree. Received & Filed May 26, 1938. Wm. P. Rowland, Clerk.

IN THE

# UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE THIRD CIRCUIT.

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MARCH TERM, 1938.

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No. 6696.

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FIRST CHROLD CORPORATION, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

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**On Petition for Review From the United States Board of Tax Appeals.**

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## PETITION FOR REHEARING.

Comes now the above-named petitioner, by counsel, and petitions the Court for a rehearing, and as a basis for rehearing sets forth the following:

*Point I:*

The decision of this Court in the instant case, filed May 26, 1938, is at variance with the decision of the United States Circuit Court of Appeals for the Fourth Circuit in the case of *R. J. Reynolds Tobacco Company* v. *Commissioner of Internal Revenue,* decided June 6, 1938 and reported at

paragraph 5.489, 1938 Prentice-Hall Federal Tax Service, and at paragraph 9373, 1938 C.C.H. Federal Tax Service.

*Point II:*

This Court erred in holding that the transactions here in question constituted income transactions as distinguished from capital transactions, in view of a long line of administrative and judicial precedent holding such transactions to be capital transactions.

*Point III:*

This Court erred in deciding the case on the theory that the agreement among the original subscribers was not an agreement enforceable by law and that therefore no contract in fact existed in view of the fact that the agreement was wholly executed.

## ARGUMENT.

**Point I. Decision in Conflict With That in Reynolds Case, Circuit Court of Appeals for the Fourth Circuit:**

The question involved in this case (whether the petitioner realized taxable gain in buying and selling its own capital stock) is the same as that involved in *R. J. Reynolds Tobacco Company* v. *Commissioner of Internal Revenue*, decided on June 6, 1938 by the United States Circuit Court of Appeals for the Fourth Circuit.

In the *Reynolds* case, the facts were substantially the same as those in the instant case except that (a) petitioner in the *Reynolds* case engaged in a greater number of transactions involving its own stock than did the petitioner in this case; and (b) petitioner in that case had not at the time of issuance agreed to repurchase the stock from its shareholders as had the

petitioner here. The Circuit Court of Appeals for the Fourth Circuit in the *Reynolds* case held that petitioner realized no taxable gain from the sale of its own stock which it had previously purchased for cash. The opinion of Judge Soper in the *Reynolds* case is reported at paragraph 5.489 Prentice-Hall Federal Tax Service for 1938 and at paragraph 9373 C.C.H. Federal Tax Service for 1938.

**Point II. Court's Refusal to Pass Upon Validity of Long Continued Administrative Practice and Regulations:** In its opinion in the instant case, this Court, speaking through Judge Dickinson, said: "Whether transactions by a corporation in its own stock is a capital or income transaction thus depends upon what the transaction was. The amended Regulations recognize this distinction." It is respectfully submitted that the decision of this Court thus overlooks the fact that at the time the transactions in question took place there was in effect a Treasury regulation, based upon administrative practice over a long period, to the effect that such a transaction was a capital transaction and not an income transaction. Article 66 of Regulations 77, promulgated on February 10, 1933, provided in part as follows:

> "*Art. 66. Sale by corporation of its capital stock.*—* * * If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)"

This Treasury Regulation was in effect at the time the transactions here in question took place. The Regulation was not a new one, but was based on a long established administrative practice to the same effect, evidenced by the following regulations and rulings, among others:

Regulations 45, Arts. 542 and 563, Rev. Act of 1918
Regulations 62, Arts. 543 and 563, Rev. Act of 1921
Regulations 65, Arts. 543 and 563, Rev. Act of 1924
Regulations 69, Arts. 543 and 563, Rev. Act of 1926
Regulations 74, Arts. 66 and 176, Rev. Act of 1928
Regulations 77, Arts. 66 and 176, Rev. Act of 1932
Law Opinion 296, 5 C.B. 210
Law Opinion 426, 5 C.B. 210
Law Opinion 1035, 2 C.B. 132, 133
Law Opinion 1035, revised, 3 C.B. 160, 162
A. R. R. 693, 5 C.B. 207
A. R. R. 799, C.B. I-1, 374
I. T. 1198, C.B. I-1, 275
I. T. 1736, C.B. II-2, 274
I. T. 1802, C.B. II-2, 267
Solicitor's Memorandum 2205, C.B. III-2, 244

Moreover, this interpretation of the law has been consistently followed by the Board of Tax Appeals and the Courts in the following decisions, among others:

*Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803 (1925).
*Cooperative Furniture Co.*, 2 B. T. A. 165 (1925).
*Atlantic Carton Corp.*, 2 B. T. A. 380 (1925).
*Emerson Electric Mfg. Co.*, 3 B. T. A. 932 (1926).
*Illinois Rural Credit Assn.*, 3 B. T. A. 1178 (1926).
*Hutchins Lumber & Storage Co.*, 4 B. T. A. 705 (1926).
*Liberty Agency Co.*, 5 B. T. A. 778 (1926)
*105 West 55th St., Inc.*, 15 B. T. A. 210 (1929), affirmed 42 F. (2d) 849.

*J. H. Johnson*, 19 B. T. A. 840 (1930), affirmed 56 F. (2d) 58.
*American Cigar Co.*, 21 B. T. A. 464 (1930), affirmed 66 F. (2d) 425.
*Inland Finance Co.*, 23 B. T. A. 199 (1931), affirmed 63 F. (2d) 886.
*Carter Hotel Co.*, 25 B. T. A. 933 (1932), affirmed 67 F. (2d) 642.
*Ohio Central Telephone Co.*, 28 B. T. A. 96 (1933).

It seems, therefore, that the amended Regulations, promulgated after the transactions in question had taken place, should not be material to the decision in this case. In this connection the Circuit Court of Appeals in the *Reynolds* case said:

> "We do not undertake to say that the present regulation would not have been a correct interpretation of the statute, as applied to such facts as are now before us, if it had been promulgated in 1918. But, as we have seen, the prevailing opinion in that year and thence continuously until 1934 forbad the taxation of such a profit as the Tobacco Company earned in 1929 in the sale of its own stock; and Congress in the light of this interpretation of its intent reenacted in substantially the same words the definition of income subject to tax in five successive carefully considered revenue acts. * * *"

It is therefore believed that this Court should have decided this case on the law as interpreted by the regulations in existence at the time the transactions took place, and in accordance with the long established administrative practice upon which such regulations were based. As the Circuit Court of Appeals for the Fourth Circuit said in the *Reynolds* case:

> "* * * the rule is well settled that if a statute is reasonably susceptible of two constructions, its

> reenactment after an interpretative ruling by responsible officials amounts to a legislative sanction of the course pursued. Especially is this true when the construction has been long maintained and several reenactments of the language in dispute have taken place.* * *"

**Point III. Third Party May Not Question Validity of Unenforceable Contract if Parties Thereto Elect to Carry It Out:** In deciding this case, the Court held that the agreement among the original subscribers was only a "gentleman's agreement" and did not give rise to a legal obligation on the part of the corporation to take its stock from dissatisfied subscribers.

It is submitted that the Court erred in treating the executed contract as if there were no contract at all. Admittedly, the contract would have been more formal had it been reduced to writing, but the parties were friends (and the Board so found) and regarded their oral promises to be as honorable as written ones.

The promise to buy the stock back, made at the time the stock was sold, was just as important an element of the consideration in the contract as was the payment of the money by the purchasers. The contract was enforceable in law unless the opposing party pleaded the statute of frauds, and since the parties elected to stand by their oral promises, certainly the Government may not complain.

That the Government may not complain of loss of revenue simply because taxpayers elect to deal honestly without regard to the statute of limitations or statute of frauds is shown by the following authorities:

Williston on Contracts, Vol. I, Sec. 530, states the rule as follows:

> "Sec. 530. *Third persons cannot take advantage of the Statute.*

"It follows from what has been stated that a contract or sale within the statute is valid except that it cannot be enforced against either party or his successor in interest unless the statute has been satisfied as to him. A third party should not be able to assert the invalidity of such transactions, unless he is an assignee or successor to a party to the contract. In general the authorities support this view. * * *"

This rule is followed in Secs. 218 and 219 of the Restatement of the Law of Contracts and is also supported by the following decisions:

*Francis M. Camp* v. *Commissioner of Internal Revenue*, 21 B.T.A. 962, acquiesced in by the Commissioner of Internal Revenue, X-1 C. B. 11.

*Alfred T. Wagner* v. *Commissioner of Internal Revenue*, 17 B.T.A. 1030, acquiesced in by the Commissioner of Internal Revenue, IX-1 C. B. 56.

*Joseph F. Hindes* v. *Commissioner of Internal Revenue*, 28 B.T.A. 498, affirmed in 74 F. (2d) 537 (C. C. A. 4th).

## CONCLUSION.

For the reasons set forth above, petitioner prays that a rehearing be granted.

Respectfully submitted,

JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.,
*Attorney for Petitioner.*

*Of Counsel:*
MAUDE ELLEN WHITE,
MILLER & CHEVALIER,
Washington, D. C.

I, John E. McClure, of Washington, D. C., attorney herein, do certify that in my opinion the foregoing statements are well founded, and that the petition is not presented for the purpose of creating a delay; I believe that a rehearing is necessary in order that Justice may be done and that the decision of the Court is erroneous in law.

JOHN E. MCCLURE,
*Attorney for Petitioner.*

[fol. 40] In the United States Circuit Court of Appeals for the Third Circuit, March Term, 1938

No. 6696

First Chrold Corporation, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent

Sur Petition for Rehearing

And Now, to wit June 28th after due consideration, the petition for rehearing in the above-entitled case is hereby denied.

Philadelphia, June 28, 1938.

John Biggs, Jr., Circuit Judge.

Endorsements: Order Denying Petition for Rehearing. Received & Filed June 28, 1938. Wm. P. Rowland, Clerk.

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[fol. 41] United States of America,
Eastern District of Pennsylvania,
Third Judicial Circuit, sct:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Transcript of Record and proceedings in this Court in the case of First Chrold Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 6696, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 23d day of September, in the year of our Lord one thousand nine hundred and thirty-eight and of the Independence of the United States the one hundred and sixty-third.

Wm. P. Rowland, Clerk of the U. S. Circuit Court of Appeals, Third Circuit. (Seal United States Circuit Court of Appeals, Third Circuit.)

[fol. 42] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 7, 1938

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is assigned for argument immediately following No. 328.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ

(5) The Commissioner of Internal Revenue has applied for a writ in the *Reynolds* case, No. 328. If that writ is granted, such action would be an added reason for granting this application.

## Conclusion.

Wherefore, it is respectfully submitted that the petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Third Circuit should be granted.

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Washington, D. C.,
*Counsel for Petitioner.*

ROBERT N. MILLER,
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Washington, D. C.,
*Of Counsel.*

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CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1938

No. 385

FIRST CHEROLD CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1938

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No.

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FIRST CHROLD CORPORATION, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

---

The petitioner, by counsel, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on May 26, 1938, affirming a decision of the United States Board of Tax Appeals, and order of the court of June 28, 1938, denying petition for rehearing filed June 24, 1938.

### Opinion Below.

The opinion of the Board of Tax Appeals (R. 16) is unreported. The opinion of the Circuit Court of Appeals (R. 33) is reported in 97 F. (2d) 22.

# INDEX.

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## Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 26, 1938 (R. 36). Thereafter, and on June 24, 1938, petitioner filed a petition for rehearing with the Circuit Court, which was denied on June 28, 1938 (R. 47). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## Questions Presented.

The following are the questions involved:

(a) Whether the petitioner was dealing in its own capital stock.

(b) Whether the petitioner, a corporation, realized gain in reselling its own capital stock, and if so, then—

(c) Whether the gain arose in the year when the petitioner bought its outstanding capital stock (as petitioner contends under *United States* v. *Kirby Lumber Company*, 284 U. S. 1), or in a later year when petitioner sold an equal number of shares (as held by the Circuit Court of Appeals).

## Statement.

The facts as found by the Board of Tax Appeals (R. 16, et seq.) are substantially as follows:

The petitioner corporation was organized on April 8, 1930, for the purpose of dealing in stocks listed on the New York Stock Exchange (R. 16-17). The petitioner's stock was not listed on any exchange (R. 17). Mr. Gerald M. Loeb, a partner of E. F. Hutton & Company of New York City, formed and managed the petitioner corporation from the time of its organization through the taxable year (R. 17). At the time the corporation was formed it promised its stockholders that if at any time they wanted to withdraw from the company for any reason the petitioner would take their stock off their hands (R. 17). During the

break in the market in 1931 and 1932 the petitioner, pursuant to its promise to its stockholders, purchased from them 2,326 shares of its own stock as against 420 shares sold (R. 18). The purchases and sales of stock were made on the basis of liquidating value, plus or minus a marginal difference to take care of inaccuracies (R. 20).

During 1933, when market conditions were somewhat better, it sold 662 shares (as against none purchased) for $92,593.05 (R. 19-20). In filing its tax return petitioner reported no gain or loss from buying and selling its own stock, and the regulations of the Commissioner, as approved by the Secretary of the Treasury, at that time were to the effect that a corporation realized no gain or loss in buying and selling its own stock, the pertinent provision thereof, Article 66 of Regulations 77, being set out in full at page 5 herein.

The Commissioner in auditing the petitioner's return determined a deficiency against the petitioner, and in his formal notice of deficiency (R. 7-11) found that the petitioner had realized a profit of $27,944.65, on the theory that during 1933 petitioner had sold 662 shares of common stock for $92,593.05, and that petitioner in 1931 had acquired an equal number of shares at a cost of $64,648.40 (R. 10, 20).

When the petitioner purchased the shares of its own stock, they were charged to an account designated "Treasury Stock" in the amounts paid therefor, and were carried as such on the liability side as a deduction from capital stock authorized and issued. Purchases of stock or securities, other than shares of its own capital stock were carried in separate accounts, on the asset side, as assets (R. 20).

From the determination of the Commissioner of Internal Revenue the petitioner appealed to the United States Board of Tax Appeals (R. 3-13), claiming (a) that it was not "dealing" in its own stock, and therefore realized no taxable profit, and (b) that if the petitioner was "dealing" in its own stock, then such gain as was realized occurred in 1931, when the stock was purchased, in that, under the fol-

was assigned for hearing immediately following No. 328, *Helvering, Commissioner* v. *R. J. Reynolds Tobacco Company.* The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## Questions Presented.

The following are the questions involved:

(a) Whether the petitioner was dealing in its own capital stock.

(b) Whether the petitioner realized gain in reselling its own capital stock, and if so, then—

(c) Whether the gain arose in the year when the petitioner bought its outstanding capital stock (as petitioner contends under *United States* v. *Kirby Lumber Company*, 284 U. S. 1), or in a later year when petitioner sold an equal number of shares (as held by the Circuit Court of Appeals).

## Statutes Involved.

There is no provision in the Revenue Act of 1932 dealing specifically with the subject matter. As originally issued on February 10, 1933, Article 66 of Regulations 77 (promulgated under the 1932 Act) provided as follows:

> "*Art. 66. Sale by corporation of its capital stock.*— The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation pur-

lowing statement by the Supreme Court in *United States* v. *Kirby Lumber Company*, 284 U. S. 1, 3—

> " * * * As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here * * *."

gain or loss occurred when petitioner repurchased the certificates of stock in 1931 (R. 6).

The case was tried before the Board on the foregoing issues. The Board decided for the respondent and entered orders accordingly. Thereafter an appeal was taken to the Circuit Court of Appeals for the Third Circuit (R. 24-27), where the decision of the Board was affirmed.

**Specification of Errors to be Urged.**

The Circuit Court of Appeals erred:

(1) In holding that the petitioner was dealing in its own capital stock.

(2) In holding that the petitioner realized a taxable profit in 1933 in reselling some of its capital stock purchased in 1931.

(3) If, as a matter of law, the petitioner realized gain or loss in buying and selling its own stock, then the court erred in not holding that the profit, if any, was realized in 1931 when petitioner repurchased its stock and not in 1933 when the stock was resold.

**Reasons for Granting the Writ.**

(1) The decision of the court below is in direct conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69, and the decision by the Circuit Court of Appeals

for the Fourth Circuit in *R. J. Reynolds Tobacco Company* v. *Commissioner*, 97 F. (2d) 302.

In those two cases, as well as in the instant case, the taxpayers were corporations which had resold some of their own capital stock at a price in excess of the price at which it had been redeemed. Both the Second and the Fourth Circuit Courts of Appeals held that a corporation does not realize a gain or sustain a loss upon reselling its capital stock.

(2) The decision below is erroneous. It disapproves the regulations issued by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. Article 66 of Regulations 77, promulgated on February 10, 1933, provided in part as follows:

> "Art. 66. Sale by corporation of its capital stock.—* * * If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See Article 176.)"

This Treasury Regulation was in effect at the time the transactions here in question took place. The Regulation was not a new one, but was based on a long established administrative practice to the same effect, evidenced by the following regulations and rulings, among others:

Regs. 45, Arts. 542 and 563, Rev. Act of 1918,
Regs. 62, Arts. 543 and 563, Rev. Act of 1921,
Regs. 65, Arts. 543 and 563, Rev. Act of 1924,
Regs. 69, Arts. 543 and 563, Rev. Act of 1926,
Regs. 74, Arts. 66 and 176, Rev. Act of 1928,
Regs. 77, Arts. 66 and 176, Rev. Act of 1932,

chases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)"

Subsequently to the decision of the First Circuit in the case of *Commissioner* v. *S. A. Woods Machine Company*, 57 F. (2d) 635, the Commissioner amended the regulations by T. D. 4430, XIII-1 C. B. 36 (May 2, 1934) to read as set out at pages 10-11 herein.

**Statement.**

The facts as found by the Board of Tax Appeals (R. 16, *et seq.*) are substantially as follows:

The petitioner corporation was organized on April 8, 1930, for the purpose of dealing in stocks listed on the New York Stock Exchange (R. 16-17). The petitioner's stock was not listed on any exchange (R. 17). Mr. Gerald M. Loeb, a partner of E. F. Hutton & Company of New York City, formed and managed the petitioner corporation from the time of its organization through the taxable year (R. 17). At the time the corporation was formed it promised its stockholders that if at any time they wanted to withdraw from the company for any reason the petitioner would take their stock off their hands (R. 17). During the break in the market in 1931 and 1932 the petitioner, pursuant to its promise to its stockholders, purchased from them 2,326 shares of its own stock as against 420 shares sold (R. 18). The purchases and sales of stock were made on the basis of liquidating value, plus or minus a marginal difference to take care of inaccuracies (R. 20).

During 1933, when market conditions were somewhat better, it sold 662 shares (as against none purchased) for $92,593.05 (R. 19-20). In filing its tax return petitioner reported no gain or loss from buying and selling its own

Law Opinion 296, 5 C. B. 210.
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Law Opinion 1035, revised, 3 C. B. 160, 162,
A. R. R. 693, 5 C. B. 207,
A. R. R. 799, I-1 C. B. 374,
I. T. 1198, I-1 C. B. 275,
I. T. 1736, II-2 C. B. 274,
I. T. 1802, II-2 C. B. 267,
Solicitors Memorandum 2205, III-2 C. B. 244.

(3) The sale of treasury stock by a corporation is a capital transaction upon which gain or loss is not recognizable for tax purposes. When a corporation acquires its own stock it has not purchased an asset—it has satisfied a liability; a capital rather than a debt liability it is true, yet in the strictest sense of the word a liability. A share of stock is representative of an ownership interest in the corporation itself. When stock is reacquired by the corporation, the stock does not take the place of the assets exchanged therefor. In fact the corporation has less than it had before. True, each share of stock still outstanding represents a greater proportionate interest in the remaining assets, but this is because the capital liability of the corporation has been satisfied in part and the ownership interest of the stockholders in the assets has shifted.

When treasury stock is retired and new shares are issued, the corporation acquires new capital and assumes an additional capital liability. The liability is the obligation of the corporation, through its officers and directors, to account to its shareholders for its use of the assets in accordance with the law and its charter. From the standpoint of the corporation it is a purchase rather than a sale. And the purchase is accomplished not by an exchange of assets, but by the creation of a capital liability, because in no real sense was the treasury stock an asset or a liability.

Stock reacquired by the issuing corporation may be either retired or allowed to remain in the treasury. In the

stock, and the regulations of the Commissioner, as approved by the Secretary of the Treasury, at that time were to the effect that a corporation realized no gain or loss in buying and selling its own stock, the pertinent provision thereof, Article 66 of Regulations 77, being set out in full at pages 2-3 herein.

The Commissioner in auditing the petitioner's return determined a deficiency against the petitioner, and in his formal notice of deficiency (R. 7-11) found that the petitioner had realized a profit of $27,944.65, on the theory that during 1933 petitioner had sold 662 shares of common stock for $92,593.05, and that petitioner in 1931 had acquired an equal number of shares at a cost of $64,648.40 (R. 10, 20).

When the petitioner purchased the shares of its own stock, they were charged to an account designated "Treasury Stock" in the amounts paid therefor, and were carried as such on the liability side as a deduction from capital stock authorized and issued. Purchases of stock or securities, other than shares of its own capital stock were carried in separate accounts, on the asset side, as assets (R. 20).

From the determination of the Commissioner of Internal Revenue the petitioner appealed to the United States Board of Tax Appeals (R. 3-13), claiming (a) that it was not "dealing" in its own stock, and therefore realized no taxable profit, and (b) that if the petitioner was "dealing" in its own stock, then such gain as was realized occurred in 1931, when the stock was purchased, in that, under the following statement by the Supreme Court in *United States* v. *Kirby Lumber Company*, 284 U. S. 1, 3—

> "* * * As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here * * *."

gain or loss occurred when petitioner repurchased the certificates of stock in 1931 (R. 6).

The case was tried before the Board on the foregoing issues. The Board decided for the respondent and entered orders accordingly. Thereafter an appeal was taken to the Circuit Court of Appeals for the Third Circuit (R. 24-27), where the decision of the Board was affirmed.

**Specification of Errors to be Urged.**

The Circuit Court of Appeals erred:

(1) In holding that the petitioner was dealing in its own capital stock.

(2) In holding that the petitioner realized a taxable profit in 1933 in reselling some of its capital stock purchased in 1931.

(3) If, as a matter of law, the petitioner realized gain or loss in buying and selling its own stock, then the court erred in not holding that the profit, if any, was realized in 1931 when petitioner repurchased its stock and not in 1933 when the stock was resold.

**Summary of Argument.**

I. The sale of treasury stock by a corporation is a capital transaction upon which gain or loss is not to be recognized for tax purposes. *Eisner* v. *Macomber,* 252 U. S. 189; *Appeal of J. H. Johnson, et al.,* 19 B. T. A. 840 (1930), affirmed C. C. A. 5, 56 F. (2d) 58, certiorari denied 286 U. S. 551 (1932).

II. The regulations of the Treasury Department from 1909 through the taxable year here in question specifically provided that a corporation realizes no gain or loss in buying or selling its own stock. In view of the repeated reenactments by Congress, without change, of the various revenue laws, the Treasury Department's construction is not to be overturned or overruled except for weighty rea-

latter event it is not an asset any more than a bond is an asset of the obligor. Its only value is a potential one, determined upon reissue by the real assets of the corporation. Authorized but unissued stock has the same character of exchangeable value, yet it would not be called an asset. Treasury stock does not differ from authorized and unissued stock. It does not carry voting power and it has no dividend rights. It cannot represent any interest in the corporation or in the assets of the corporation. Both the New York Stock Exchange and the Securities & Exchange Commission recognize this when they prohibit a corporation from carrying treasury stock as an asset.

In short, when a corporation sells its treasury stock it is deriving capital and not deriving a profit from capital. Capital derived is not taxable as income; it is the gain derived from capital that is taxable. *Eisner* v. *Macomber*, 252 U. S. 189. Thus when a corporation sells its treasury stock it is doing nothing more than deriving additional capital.

(4) The profit, if any, arose in 1931, when the petitioner purchased its outstanding stock and not in 1933 when the treasury stock was resold. *United States* v. *Kirby Lumber Company*, 284 U. S. 1. In the *Kirby Lumber Company* case the Supreme Court held that a corporation realized a taxable gain when it had repurchased some of its outstanding bonds at a price less than the issuing price of the bonds. If corporation A realizes a profit of $100 in purchasing for $900 one of its outstanding bonds which had been sold for $1,000, then on reason and principle Corporation B would have a $10 profit if it buys in for $90 one of its shares of stock which had been sold for $100. Applying that principle to the facts in this case, any gain or loss which First Chrold Corporation realized must have occurred in 1931 when it purchased the outstanding stock which was issued when the corporation was formed in 1930.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1938.

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No. 385.

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FIRST CHROLD CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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## BRIEF FOR PETITIONER.

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### Opinion Below.

The opinion of the Board of Tax Appeals (R. 16) is unreported. The opinion of the Circuit Court of Appeals (R. 33) is reported in 97 F. (2d) 22.

### Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 26, 1938 (R. 36). Thereafter, and on June 24, 1938, petitioner filed a petition for rehearing with the Circuit Court, which was denied on June 28, 1938 (R. 47). The petition for a writ of certiorari was filed September 27, 1938, and was granted November 7, 1938, and the case

sons. *United States* v. *Jackson*, 280 U. S. 183, 193, 196; *Fawcus Machine Company* v. *United States*, 282 U. S. 375, 378; *E. R. Squibb & Sons* v. *Helvering*, (C. C. A. 2d) 98 F. (2d) 69, 70; and other cases.

Whatever force a change in applicable regulations may have prospectively, such provision should not be applied retroactively.

III. The rule that a corporation realizes gain or loss in buying and selling its own stock is limited to those cases where the corporation is dealing in its own stock in the same manner as if it were dealing in the shares of another corporation either for speculative purposes or for investment. Clearly the facts in this case show that the petitioner was not dealing in its own stock. It did not speculate in its stock, nor did it buy for investment, nor was the stock so carried on petitioner's books. The stock which it acquired was carried in a separate account on the liability side. Stocks of other corporations which the petitioner acquired were carried under separate accounts on the asset side.

IV. If the petitioner is to be charged with gain in buying and selling its capital stock, then gain or loss was realized when the stock was repurchased and not when an equal number of shares were later sold. *United States* v. *Kirby Lumber Company*, 284 U. S. 1. As an illustration, if a corporation repurchases at $90 shares which were sold previously at $100, clearly the corporation "has realized within the year an accession to income." *United States* v. *Kirby Lumber Company, supra.* No stock having been repurchased in 1933 (the year involved herein), no gain occurred in that year.

V. If respondent's contentions in the court below were to be adopted, absurd results would follow.

## Argument.

### POINT I.

THE SALE OF TREASURY STOCK IS A CAPITAL TRANSACTION UPON WHICH GAIN OR LOSS IS NOT RECOGNIZABLE FOR TAX PURPOSES.

When the petitioner purchased the shares of its own stock they were charged to an account designated "Treasury Stock" in the amount paid therefor, and they were carried as such on the liability side as a deduction from issued capital. They were not regarded as an investment and were not carried in the accounts along with other securities (R. 20). This is similar to a partial liquidation. If an acquisition of shares is pro rata from all its stockholders, it is clear that the only result is that the corporation has distributed a part of its assets to its stockholders as a distribution in partial liquidation. It is no less clear that a distribution has taken place when the stock is acquired otherwise than pro rata from stockholders. When a corporation acquires its own stock, it has not purchased an asset—it has satisfied a liability; a capital rather than a debt liability, it is true, yet in the strictest sense of the word a liability. A share of stock is representative of an ownership interest in the corporation itself. When stock is reacquired by the corporation, the stock does not take the place of the assets distributed. In fact the corporation has less than it had before. True, each share of stock still outstanding represents a greater proportionate interest in the remaining assets, but this is because the capital liability of the corporation has been satisfied in part and the ownership interest of the stockholders in the assets has shifted.

When treasury stock is retired and new shares are issued, the corporation acquires new capital and assumes an additional capital liability. The liability is the obligation of the corporation, through its officers and directors, to account to its stockholders for its use of the assets in accordance with the law and its charter. From the standpoint

of the corporation it is a purchase rather than a sale. And the purchase is accomplished not by an exchange of assets, but by the creation of a capital liability, because in no real sense was the treasury stock an asset or a liability.

Stock reacquired by the issuing corporation may be either retired or allowed to remain in the treasury. In the latter event it is not an asset any more than a bond is an asset of the obligor. Its only value is a potential one, determined upon reissue by the real assets of the corporation. Authorized but unissued stock has the same character of exchangeable value, yet it would not be called an asset. Surely no further argument is necessary to sustain the proposition that treasury stock is not an asset. On the other hand, if it is a liability, its repurchase falls within the *Kirby Lumber* case, *supra*.

The pertinent regulation is clear to the effect that neither gain nor loss is incurred upon the original issue of stock. If acquired stock is retired but subsequently an equal number of shares of stock is sold at a price greater than the cost of the stock retired, the substitution results in an accretion of assets to the corporation which would not be considered taxable income. Assuming the newly issued shares were equal in number to the shares retired, the capital liability of the corporation would remain the same, surplus would be increased and yet there would be no realization of income under the regulation.

Treasury stock does not differ from authorized and unissued stock. It does not carry voting power and it has no dividend rights. It cannot represent any interest in the corporation or in the assets of the corporation. Both the New York Stock Exchange and the Securities & Exchange Commission recognize this when they prohibit a corporation from carrying treasury stock as an asset.

In short, when a corporation sells its treasury stock it is deriving capital and not deriving a profit from capital. It is doubtful whether it would be within the power of Congress to levy an income tax upon a corporation in the sale

of its treasury stock because, in *Eisner* v. *Macomber*, 252 U. S. 189, at page 207, income is defined as—

> "'* * * the gain derived from capital, from labor, or from both combined,' * * *";

also at page 207 the Supreme Court stated:

> "Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain', which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived,—*'derived-from-capital;'—'the gain-derived-from-capital,'* etc."

In other words, capital derived is not taxable as income, it is the gain derived from capital that is taxable. Consequently, when a corporation sells its treasury stock, it is doing nothing more than deriving additional capital.

The construction sought by the respondent in support of the proposed assessment would probably lead to an unconstitutional levy upon capital. Such a construction should be avoided. *Lucas* v. *Alexander*, 279 U. S. 573, 577-8; *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 348-9.

## POINT II.

### During the Taxable Year Here in Question and for a Long Period Prior Thereto the Regulations of the Treasury Department Specifically Ruled That a Corporation Had No Gain or Loss in Buying and Selling Its Own Stock, Founding the Ruling on the Principle That the Transactions Involved Were Capital in Nature.

All the revenue laws, beginning with that of 1909, are completely silent on the question whether a corporation realizes gain or loss in buying and selling its own stock.

However, until amended on May 2, 1934, the respective regulations have consistently specifically provided that gain or loss was not to be recognized from such transactions. For instance, Regulations 77, interpreting the Revenue Act of 1932, and promulgated on February 10, 1933, provide in Article 176 in part as follows:

> "A corporation sustains no deductible loss from the sale of its capital stock. (See article 66.)"

Article 66 of said Regulations, set out in full at pages 2-3 herein, provides in part:

> "* * * or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock."

It was not until after the taxable year here involved that the Commissioner changed his regulations so as to provide that *in certain instances* a corporation would realize gain or loss upon the sale of its own stock, the rule providing that if a corporation "deals* in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another." This change was made by T. D. 4430, XIII-1 C. B. 36, which was promulgated on May 2, 1934, and which amended Article 66 of Regulations 77 to read as follows:

> "*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The

*We point out hereinafter, pages 14-18, that the petitioner was not dealing in the shares of its own capital stock.

receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes."

Whatever force the foregoing regulations may have prospectively, they should not be applied retroactively. Certainly a return properly filed under the regulations as they existed at the time it was filed ought not to be disturbed except for very cogent reasons.

We maintain that where the regulations of the Commissioner, promulgated with the approval of the Secretary of the Treasury, provide that gain or loss is not to be recognized by a corporation in buying and selling its own stock, on the principle that the transaction is capital in nature, they should not be disturbed where repeatedly reenacted by Congress. The rule of construction is that where statutes are reenacted after long continued interpretation, such reenactment amounts to an adoption by Congress of such construction.

*National Lead Company* v. *United States*, 252 U. S. 140;

*United States* v. *Alabama Great Southern R. Co.*, 142 U. S. 615;

*Luckenbach Steamship Co.* v. *United States*, 280 U. S. 173;

*Copper Queen Consolidated Mining Co.* v. *Arizona*, 206 U. S. 474;
*United States* v. *Cerecedo Hermanos y Compania*, 209 U. S. 337;
*United States* v. *Jackson*, 280 U. S. 183;
*Brewster* v. *Gage*, 280 U. S. 327;
*Universal Battery Co.* v. *United States*, 281 U. S. 580, 583;
*Fawcus Machine Co.* v. *United States*, 282 U. S. 375;
*McCaughn* v. *Hershey Chocolate Company*, 283 U. S. 488, 492-3;
*Massachusetts Mutual Life Insurance Co.* v. *United States*, 288 U. S. 269;
*Murphy Oil Co.* v. *Burnet*, 287 U. S. 299;
*Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552.

In *United States* v. *Jackson, supra*, Mr. Chief Justice Taft stated the rule clearly (p. 193):

> "It is a familiar rule of statutory construction that great weight is properly to be given to the construction consistently given to a statute by the Executive Department charged with its administration (citing cases); and such construction is not to be overturned unless clearly wrong, or unless a different construction is plainly required * * *."

In *Universal Battery Company* v. *United States, supra*, the Supreme Court stated (p. 583):

> "This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong."

In *Fawcus Machine Company* v. *United States, supra*, Mr. Justice Roberts said (p. 378):

> "The regulations were made pursuant to express authority (see Sec. 1309 of the Revenue Act of 1918). They are valid unless unreasonable or inconsistent with the statute. (Citing cases.) They constitute contemporaneous construction by those charged with the

> administration of the act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons."

In *Massachusetts Mutual Life Insurance Company* v. *United States, supra,* Mr. Justice Roberts also said (p. 273):

> "If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute (citing cases) * * *."

The rule enunciated by the Supreme Court in the cases above referred to was recently applied by the Second Circuit Court of Appeals in a situation similar to that in the instant case and involving the same regulations. See *E. R. Squibb & Sons* v. *Helvering,* 98 F. (2d) 69, in which Judge Learned Hand says, at page 70:

> "We share the taxpayer's doubts whether it dealt 'in its own shares as it might in the shares of another corporation', within the very equivocal language of the regulation. It is at least arguable that this means to cover only speculations of a corporation, and not a profit-sharing enterprise like that at bar. But in any event it seems to us that the uniform interpretation, so long placed upon § 22(a), 26 U. S. C. A. § 22(a), by the regulation and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it."

In view of the long continued practice of the Treasury Department in officially ruling that a corporation realizes no gain or loss in buying and selling its stock, there is now no basis in law for the Commissioner to claim, or for the Board to decide, that the amended regulations, promulgated after the return here in question had been filed, should be applied retroactively. The repeated reenactments by Congress, without change, of the various revenue acts, disclose a Congressional intent not to regard a corporation as real-

izing gain or loss upon buying and later selling its own stock, and whatever force the regulation as amended on May 2, 1934, may have prospectively, it is not to be applied to transactions completed prior to that date. Moreover, since the petitioner herein was not dealing in its own stock, but bought and sold its stock in order to carry out its promise to its stockholders, who contributed capital in the first instance, it is doubtful, as we point out on pages 8-9 herein, whether it would be within the power of Congress to levy a tax in such situation, even if it undertook to do so.

## POINT III.

### The Petitioner Was Not Dealing in Its Own Capital Stock.

As was said in *Commissioner* v. *S. A. Woods Machine Company*, 57 F. (2d) 635, by the First Circuit Court of Appeals (p. 636):

> "Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved."

The record in the case at bar shows that during 1931 and 1932 the petitioner, pursuant to its promise to its stockholders to take the stock off their hands in the event they so desired (R. 17), purchased 2,326 shares of its own stock (R. 18). These purchases were made in a declining market. In the next year when the market conditions were better the petitioner sold 662 shares and made no purchases (R. 19). These isolated transactions are not sufficient to support a holding that the petitioner was dealing in its own stock, for it never really wanted to buy its own stock. All the petitioner did was to carry out its original promise to buy the stock back from the stockholders in the event such stockholders wanted to dispose of their interest in the corporation.

The purchases and sales made were at one point from the liquidating value. This, as the Board found, was to take care of inaccuracies (R. 20). In so doing the petitioner not only was not dealing in its own stock, but even if it were, contrary to our contention, no taxable gain in fact resulted. What occurred when the stock was sold was that new subscribers were permitted to come into the corporation on exactly the same basis as the old subscribers had at the time. It was like an existing partnership taking in a new partner on the basis of current worth. Surely one would not say that the old partners had realized income in such a situation, if the money contributed by the new member remained in the venture.

Take the case where subscribers have paid in to the corporation $100,000 for 1,000 shares at $100, which was used to buy listed securities. If those securities decrease in value to $90,000 the corporation's stock should sell at $90. Or if the market should go the other way and the securities become worth $125,000, the corporation's stock should sell at $125.00. If it sold a share for $125.00 the corporation, while $125.00 better off than before, is so because of a capital transaction. To argue the contrary is to close one's eyes to the theory of corporate taxation, viz., to tax the corporation on the profit from the sale of corporate assets and regard the sale of the corporate stock as the capital transaction which brings into being or continues in existence the separate corporate entity.

When a corporation sells a share of stock, it thereby receives into its assets the price of the stock, and gives to the purchaser a certificate evidencing his right to participate in the management of the company, to receive a pro rata share of its profits, and upon liquidation a pro rata distribution of its assets. These are proprietorship transactions, as distinguished from profit and loss transactions. If a company has been prosperous and its assets have increased in value, it may sell shares at a premium—each share's participating rights being of greater value than the

original par or issuing price. But it has never been suggested that such amount of the selling price as exceeds par is income or profit, nor that it is anything but capital paid in to the corporation as a part of the consideration for the stockholder's participating rights.

Where stock is bought back after issuance, and held as treasury stock, it ceases to have participating rights of any kind. By its withdrawal from the public, the price paid for it is taken out of the corporation's assets, but the remaining shares outstanding then participate in larger pro rata fractions in the assets remaining. So far as the corporation is concerned, no gain or loss is realized for tax purposes, in such a transaction; if the share is repurchased for less than its issuing price, the difference represents capital paid in and abandoned by the shareholder; if for more than its issuing price, the difference represents a reduction of capital.

Even admitting, which we do not, that a corporation which deals in its own stock as it would in that of another company, realizes taxable income or suffers deductible loss from such dealing, petitioner here contends it was not *dealing* in its own stock in any sense.

In order to sell its stock originally, petitioner promised to the subscribers—there were only some 60 or 70 of them, and all friends of the manager—that the corporation would repurchase the stock if they wished to sell (R. 17). The stock of petitioner was not listed on any exchange (R. 17). In accordance with its promise, petitioner did, in 19 instances during 1931, repurchase stock, and did so in 5 instances in 1932. In 1931 it sold only 210 shares, in lots ranging from 10 to 90 shares, in 5 different sales; in 1932 it sold one lot of 10 shares and one lot of 200 shares (R. 18). These figures indicate there was little market for the stock in those years, and considerable demand for repurchase by those who had previously bought stock. In 1933, with a general business uplift, the company was able to sell 662 shares; it bought none in that year (R. 19).

*G. C. M. 12955*, XIII-1 C. B. 107, is predicated on *T. D. 4430*, XIII-1 C. B. 36. Its headnote reads:

> "The gain derived by the M Corporation from dealing in its own stock for the purpose of profit in the ordinary course of business is subject to Federal income tax."

This memorandum presents facts almost directly opposite to those of the instant case. We quote from the G. C. M.:

> "The balance sheets of the M Corporation show that a substantial part of its surplus was, during the year involved, employed in trafficking in its own stock. For several years the taxpayer had been engaged in such transactions. Its income tax return for the year 1929 reflects a profit from dealing in its own stock of 50x dollars. On the books and records of the corporation the purchases and sales of its own stock were treated in the same manner as other security investments. All the purchases and sales in question were made on the open market and were recorded in the investment account of the corporation. Gains and losses on such transactions were duly reflected in its profit and loss account and in its surplus account. * * *"

No substantial part of petitioner's surplus was employed in trafficking in its own stock; it did not deal in its own stock as it would in that of another company; it did not treat the treasury stock as an investment; it did not buy the stock in the open market, but bought only as its personally-known stockholders wished to withdraw, its main object being to afford those stockholders who found it necessary to liquidate their shares a means of doing so by turning them over to the corporation.

The petitioner did not acquire its capital stock in exchange for assets sold, or in payment of liabilities due it, as was the situation in the *S. A. Woods Machine Company* case, *supra;* petitioner did not issue its shares nd treat the proceeds as an item of income; these were capital transactions and were so treated; if they resulted in a gain, it

was not a taxable item. It is not necessary that every addition or accretion to capital enter the corporate structure through the door of income.

That the petitioner was not dealing in its own stock and never intended to, is shown by the following:

(a) The stock was not carried as an investment like other securities, but was carried on the liability side as a deduction from issued capital.

(b) The fewness of the transactions detracts from the thought that the petitioner was dealing in its stock. Dealing in stock implies there is a dealer. But infrequent transactions are not sufficient to constitute one a dealer. *Pan-American Bank & Trust Company,* 5 B. T. A. 839. Said the Board (p. 845):

> "From the evidence we are of the opinion that the infrequent and isolated transactions in corporate and municipal bonds with the depositors of petitioner are not sufficient to constitute petitioner a dealer in securities."

(c) There was no profit motive behind the purchases and sales. The motive was to induce persons to become new subscribers.

## POINT IV.

### Assuming that the Petitioner Was Dealing in Its Own Stock, Contrary to Our Contention, Then Gain or Loss Arose in 1931 When the Petitioner Purchased Its Outstanding Stock.

The petitioner was formed on April 8, 1930, when the stock here in question was first sold. In 1931 the petitioner bought in some of its outstanding stock. Even if we assume that petitioner was dealing in its own stock, then in that year it had a gain or loss, depending upon the price at which the stock was sold in 1930. Assuming the 662 shares were sold at par, or $66,200 in 1930, then when the peti-

tioner bought in the stock for $64,648.40 in 1931 a profit of $1,551.60 was realized. This principle of taxation was announced by this Court in *United States* v. *Kirby Lumber Company*, 284 U. S. 1, involving a case where a corporation purchased its outstanding bonds. In that case the plaintiff had sold its bonds at par for $12,126,800. Later in the same year it purchased in the open market some of the same bonds at less than par, the difference in price being $137,521.30. The Supreme Court in holding that the plaintiff was taxable in buying in its outstanding bonds at less than the selling price said this (p. 3):

> "The defendant in error has realized within the year an accession to income if we take words in their plain popular meaning, as they should be taken here."

The case at bar is exactly the same in principle. If a corporation sells a share of stock for $100 and buys it back for $90, one cannot deny that the corporation has a $10 gain which it would not have had but for the transaction, "if we take words in their plain popular meaning." Applying the principles the Supreme Court laid down in the *Kirby Lumber* case, *supra*, to the present case, we have the petitioner $1,551.60 better off in 1931 than it was before.

But the Board says (R. 22-23) that while the *Kirby Lumber* case is applicable where a corporation buys in its own bonds, it does not apply where a corporation buys in its outstanding stock. It attempts to distinguish the situation by saying that in the case of bonds there is an outstanding liability but in the case of stock there is no obligation on the part of the corporation to pay the holder thereof a specified sum. Moreover, says the Board (R. 22), the value of a corporation's stock may fluctuate. Clearly these are distinctions without a difference. The principles of income taxation do not concern themselves with such refinement. They are predicated, says the Supreme Court in *Eisner* v. *Macomber*, 252 U. S. 189, 207, on—

> "'* * * the gain derived from capital, from labor, or from both combined,' * * *.

> "* * * *not* a gain *accruing to capital*, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being '*derived*,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property. * * *"

Applying the foregoing rule, it is clear that the petitioner, if it realized a gain in dealing in its stock, did so in 1931, when the profit to the extent of $1,551.60 was realized as outlined above.

If petitioner was dealing in its own stock, then when it sold 662 shares in 1933, that was the beginning of another transaction upon which gain or loss will occur, depending upon the price at which the stock is later acquired. In this connection it is to be noted that there must be two transactions before gain is realized or loss is sustained. The usual transaction begins with a purchase and ends with a sale. Frequently, as is the situation here, the events are reversed; such a reversal occurs in the case of a short sale, where the sale occurs before the purchase. The gain or loss does not arise when the sale occurs, but is postponed until the purchase is made.

In differentiating the case at bar from that of the *Kirby Lumber Company*, the Board stated (R. 22) that the value of a corporation's stock may fluctuate. In petitioner's view, such fact is immaterial in the situation here involved.

## POINT V.

### If Respondent's Contentions in the Court Below Were to be Adopted, Absurd Results Would Follow.

Just a few illustrations will show how absurd will be the results in cases arising under the rule contended for by the respondent in the court below.

1. Corporation A buys 662 of its shares at $100 a share. Thereafter the remaining stockholders make a contribution to capital of $100 a share so that the outstanding stock is now worth $200 a share. If the corporation now sells the 662 shares at $200 a share a profit of $66,200 results. What theory sustains such profit?

2. But suppose Corporation A instead of receiving a paid-in surplus of $100 a share makes a distribution of $50 a share. If the corporation now sells the 662 shares at $50 a share a loss of $33,100 results. (Clearly an artificial loss, yet it would be deductible under the respondent's view.)

3. Corporation A might have a double loss when only one loss occurs, or a double profit when only one profit occurs. Let us suppose Corporation A had $50,000 capital stock issued (worth par) and $50,000 capital stock in the treasury, for which it paid par. Now if it should have an operating loss of $25,000 and should then sell the treasury stock at its then present value of $25,000, a loss of $50,000 for the year would be the result ($25,000 operating loss and $25,000 stock loss).

4. On the other hand, if Corporation A had a $25,000 operating profit and sold the treasury stock for $75,000, the profit would be $50,000 for the year.

5. If Corporation A owns treasury stock costing more than the present fair market value of its outstanding stock it would be in a position to create a tax loss through selling its treasury stock, although such a loss would be most artificial. If Corporation A is in a position where it would have a gain should it sell its treasury stock, it could avoid the gain by the simple expedient of amending its charter and claiming the transaction to be a recapitalization.

Taking advantage of such loopholes as would exist above may not be very laudable, yet the Government ought to be the last one to dangle them before the very eyes of the taxpayers.

## Conclusion.

WHEREFORE, it is respectfully submitted that the judgment of the Circuit Court of Appeals for the Third Circuit should be reversed.

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November, 1938.

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101340—38

# In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 385

FIRST CHEROLD CORPORATION, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT*

## MEMORANDUM FOR THE RESPONDENT

### OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 16) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 33) is reported in 97 F. (2d) 22.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 26, 1938. (R. 36.) A petition for rehearing was denied on June 28, 1938. (R. 47.) A "Supplemental Petition for Rehear-

ing" was filed on July 14, 1938, which, as far as we are able to ascertain, has not yet been acted upon. The petition for certiorari was filed on September 27, 1938. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

After the taxpayer, a corporation, had originally issued its stock, it made purchases and sales of its own stock, buying and selling for cash, without any intention or authority to increase or decrease its authorized capital. During 1933, the taxable year, the taxpayer derived a gain from such trading in its own stock. However, Article 66 of Treasury Regulations 77, provided in part that a corporation realizes no gain or loss from the purchase or sale of its own stock. Subsequently the applicable regulation was amended by Treasury Decision 4430 to provide that where a corporation deals in its own stock as it might in the shares of another corporation the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. The question presented is whether this case is properly governed by the rule set forth in the original or in the amended regulation.

## STATUTE AND OTHER AUTHORITIES INVOLVED

The statute and other authorities involved will be found in the Appendix, *infra*, pp. 9–12.

STATEMENT

The facts, as stipulated, for the most part, and as found by the Board of Tax Appeals (R. 16–20) are substantially as follows:

The taxpayer is a Delaware corporation organized April 8, 1930, for the purpose of speculating in listed stocks. In the course of its business the taxpayer never owned stocks that were not listed on the Exchange. During the taxable year the taxpayer had authorized capital stock of 10,000 shares of which 5,748 were issued at approximately $100 per share. (R. 16–17.)

Mr. Gerald M. Loeb, a partner of E. F. Hutton & Company, of New York City, managed the taxpayer from the time of its organization through the taxable year. The original subscribers for the taxpayer's stock were some 60 or 70 friends of Mr. Loeb, who were promised at the time the stock was issued that the corporation would repurchase the stock if they wished to sell it, and if financial conditions permitted. The stock of the taxpayer was not listed on any stock exchange. (R. 17.)

The taxpayer made the following purchases and sales of its own stock during the period from 1931 to 1933, inclusive (R. 18–19):

| Date | Purchases | | | Date | Sales | | |
|---|---|---|---|---|---|---|---|
| | Shs. | Price | Cost | | Shs. | Price | Proceeds |
| 1931 | | | | 1931 | | | |
| Feb. 16 | 80 | 114 | $9,855.60 | Feb. 20 | 25 | 114⅝ | $2,888.38 |
| Mar. 30 | 100 | 111¼ | 11,125.00 | Feb. 24 | 35 | 116 | 4,049.85 |
| Apr. 14 | 50 | 111¼ | 5,562.50 | Mar. 31 | 50 | 113 | 5,635.00 |
| Apr. 20 | 100 Cash | 110 | 11,025.00 | Apr. 2 | 10 | 113 | 1,126.60 |
| May 6 | 50 | 108 | 5,412.50 | Apr. 16 | 90 | 111¾ | 10,031.40 |
| Aug. 4 | 100 | 109¾ | 10,100.00 | | 210 shs. | | |
| Aug. 26 | 50 | 96 | 4,810.00 | | | | |
| Aug. 27 | 50 | 96 | 4,810.00 | | | | |
| Sept. 21 | 136 | 96 | 13,063.20 | | | | |
| Sept. 30 | 50 | 98 | 4,910.00 | | | | |
| Oct. 6 | 250 Cash | 98 | 24,550.00 | | | | |
| Oct. 6 | 150 Cash | 98 | 14,730.00 | | | | |
| Oct. 8 | 150 Cash | 98 | 14,730.00 | | | | |
| Oct. 21 | 50 | 98 | 4,910.00 | | | | |
| Oct. 26 | 10 | 98 | 983.00 | | | | |
| Nov. 10 | 250 Cash | 100 | 25,062.50 | | | | |
| Nov. 13 | 50 | 100 | 5,012.50 | | | | |
| Dec. 10 | 25 Cash | 103¾ | 2,600.00 | | | | |
| Dec. 11 | 5 | 102 | 513.00 | | | | |
| | 1,686 shs. | | | | | | |

Total purchases ..... 1,686 shares
Less total sales ..... 210 "

Shs. held at end of 1931 ..... 1,476 "

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1932 | | | | 1932 | | | |
| Feb. 20 | 145 | 105¼ | $15, 439.00 | Jan. 12 | 10 | 108¾ | $1, 084.10 |
| May 11 | 24 | 105¾ | 2, 532.00 | Dec. 7 | 200 | 113.98 | 22, 726.00 |
| May 19 | 450 | 102 | 44, 012.50 | | | | |
| June 21 | 10 | 108 | 1, 083.00 | | | | |
| July 8 | 10 | 108 | 1, 083.00 | | | | |
| | 640 shs. | | | | | | |

| | |
|---|---|
| Total Purchases | 640 shares |
| Less Total Sales | 210 " |
| | 430 " |
| Balance at end of 1931 | 1, 476 " |
| Plus purchases in 1932 | 640 " |
| | 2, 116 " |
| Less sales in 1932 | 210 " |
| Balance at end of 1932 | 1, 906 " |

| Date | Purchases | | | Date | Sales | | |
|---|---|---|---|---|---|---|---|
| | Shs. | Price | Cost | | Shs. | Price | Proceeds |
| 1933 | | | | 1933 | | | |
| | | | | Feb. 23 | 20 | 117 | $2, 333.20 |
| | | | | May 3 | 5 | 132 | 656.55 |
| | | | | May 5 | 25 | 133⅛ | 3, 329.00 |
| | | | | May 8 | 50 | 133⅛ | 6, 658.00 |
| | | | | May 9 | 40 | 134 | 5, 346.00 |
| | | | | May 11 | 25 | 131⅜ | 3, 286.38 |
| | | | | May 15 | 25 | 131 | 3, 266.50 |
| | | | | May 22 | 40 | 129 | 5, 146.40 |
| | | | | June 9 | 10 | 142 | 1, 416.10 |
| | | | | June 9 | 50 | 142 | 7, 083.00 |
| | | | | June 9 | 25 | 144 | 3, 591.50 |
| | | | | July 12 | 50 | 146 | 7, 283.00 |
| | | | | Aug. 31 | 65 | 146 | 9, 467.90 |
| | | | | Sept. 1 | 3 | 146⅝ | 436.98 |
| | | | | Sept. 6 | 2 | 145⅓ | 287.83 |
| | | | | Sept. 18 | 10 | 150¾ | 1, 498.60 |
| | | | | Sept. 26 | 100 | 145 | 14, 466.00 |
| | | | | Oct. 25 | 4 | 147 | 584.64 |
| | | | | Nov. 21 | 86 | 146 | 12, 526.76 |
| | | | | Dec. 4 | 17 | 143 | 2, 425.22 |
| | | | | Dec. 19 | 10 | 150⅓ | 1, 501.10 |
| | | | | | 662 Shs. sold. | | |

| | |
|---|---|
| Balance at end of 1932 | 1, 906 shares |
| Less Sales in 1933 | 662 " |
| Balance at end of 1933 | 1, 244 " |

The taxpayer, during 1933, sold 662 shares of its own capital stock at a total selling price of $92,593.05. The Commissioner, in determining the deficiencies asserted, determined that these 662 shares of stock sold by the taxpayer during 1933 for $92,593.05 were acquired by the taxpayer during 1931 at a cost of $64,648.40 and accordingly added to income the difference of $27,944.65. The taxpayer admits that it did purchase 662 shares of its own capital stock in 1931 and sold the same number of shares in 1933 for the sums above mentioned. The purchases and sales of the stock were made on the basis of liquidating value, plus or minus a marginal difference to take care of inaccuracies. (R. 20.)

When the taxpayer purchased the shares of its own stock they were charged to an account designated "Treasury Stock" in the amounts paid therefor, and they were carried as such on the liability side as a deduction from issued capital. Upon subsequent sales of shares of the stock this account was credited with the cost of the respective shares sold, and the excess of the amount received upon the sale of shares over the price at which an equal number of shares were purchased was credited to an account designated "Surplus From Sale of Treasury Stock." No adjustment was made in the outstanding capital stock by reason of such purchases and sales, the matter being handled entirely by an increase or decrease in the treasury stock. Purchases of stock or securities other than shares of

its own capital stock were carried in separate accounts designated "Speculative Long Position in Market" and "Investment Long Position in Market." (R. 20.)

The Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals, and held that the gain derived by the taxpayer from trading in its own stock during the taxable year represented taxable income in accordance with the provisions of the amended regulation. (R. 33–35.)

## DISCUSSION

Inasmuch as, in the Government's view, the cause is properly before the Court at this time,[1] and the decision is in conflict with the decision of the Circuit Court of Appeals for the Fourth Circuit in *R. J. Reynolds Tobacco Co.* v. *Commissioner*, 97 F. (2d) 302, now pending on the Government's petition for

[1] The record does not disclose the fact, but on July 14, 1938, after its original petition for rehearing was denied, the taxpayer filed what was styled a "Supplemental petition for Rehearing," advising the court below of the decision in *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69 (C. C. A. 2d). This supplemental petition was not filed within thirty days after entry of final judgment, as required by Rule 27 of the Rules of the Circuit Court of Appeals for the Third Circuit. So far as we are able to ascertain, this petition has not yet been acted upon. Under the rule of *Gypsy Oil Co.* v. *Escoe*, 275 U. S. 498, the three-month period for filing a petition for certiorari began to run from the date of denial of the original petition, and was not suspended by the filing of the untimely "supplemental" petition, unless perhaps the latter is actually entertained by the lower court.

certiorari, No. 328, October Term, 1938, and with the decision of the Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69,[2] the Government does not oppose the granting of the writ.

Respectfully submitted.

ROBERT H. JACKSON,
*Solicitor General.*

OCTOBER 1938.

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[2] In this case the *taxpayer* filed a petition for rehearing, objecting to the decision of the court with respect to a matter not considered by either of the other circuit courts of appeals, namely that the taxpayer realized gain upon the sale of its treasury stock to the extent that the sales price exceeded the value thereof at the time of sale. On October 10, 1938, upon the suggestion of counsel for the taxpayer and with the acquiescence of counsel for the Government, the court decided to withhold action on the taxpayer's petition for rehearing, pending the action of this Court on the *R. J. Reynolds Co.* and *First Chrold Corp.* petitions.

# APPENDIX

## STATUTE AND OTHER AUTHORITIES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect." (U. S. C., Title 26, Sec. 1691.)

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

Treasury Regulations 77, relating to the Revenue Act of 1932:

> ART. 66. *Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitutes the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

Treasury Decision 4430, approved May 2, 1934, XIII–1 Cumulative Bulletin 36:

> ARTICLE 66: Sale by corporation of its capital stock XIII–20–6792 T. D. 4430
> (Also Section 23 (i), Article 176.)
>
> INCOME TAX.
>
> Acquisition or disposition by a corporation of its own capital stock.
>
> Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
*Washington, D. C.*

*To Collectors of Internal Revenue and Others Concerned:*

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, and articles 66 of Regulations 74, approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where

permitted by the provisions of applicable statutes.

Articles 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

As to the acquisition or disposition by a corporation of its own capital stock, see article 543.

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

As to the acquisition or disposition by a corporation of its own capital stock, see article 66.

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

As to the acquisition or disposition by a corporation of its own capital stock, see article 66.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved May 2, 1934.

H. MORGENTHAU, Jr.,
*Secretary of the Treasury.*

U. S. GOVERNMENT PRINTING OFFICE: 1934

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114491—38——1

# In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 385

FIRST CHEROLD CORPORATION, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT*

## BRIEF FOR THE RESPONDENT

### OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 16) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 33) is reported in 97 F. (2d) 22.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 26, 1938 (R. 36). A petition for rehearing was denied on June 28, 1938 (R. 47).

A "Supplemental Petition for Rehearing" was filed on July 14, 1938, which, as far as we are able to ascertain, has not yet been entertained or acted upon. The petition for certiorari was filed on September 27, 1938, and granted November 7, 1938 (R. 48). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTIONS PRESENTED

Petitioner in 1931, 1932, and 1933 purchased and sold shares of its own stock. In 1933, the year in question, petitioner sold for $92,593.05 662 such shares which had been purchased by it in 1931 for $64,648.40.

1. May the difference between the cost of the shares and the proceeds on sale be included in petitioner's income for 1933 under Section 22 (a) of the Revenue Act of 1932?

2. Does Article 66 of Regulations 77, as amended in 1934, apply to petitioner's transactions in its shares; and if so, must the Regulation be denied application?

## STATUTE AND OTHER AUTHORITIES INVOLVED

The statute and other authorities involved will be found in the Appendix, *infra,* pp. 19–22.

## STATEMENT

The facts, as stipulated, for the most part, and as found by the Board of Tax Appeals (R. 16–20) are in substance as follows:

The taxpayer is a Delaware corporation organized April 8, 1930, for the purpose of speculating in listed stocks. In the course of its business the taxpayer never owned stocks that were not listed on the Exchange. During the taxable year the taxpayer had authorized capital stock of 10,000 shares, of which 5,748 were issued at approximately $100 per share (R. 16–17).

Mr. Gerald M. Loeb, a partner of E. F. Hutton & Company, of New York City, managed the taxpayer from the time of its organization through the taxable year. The original subscribers for the taxpayer's stock were some 60 or 70 friends of Mr. Loeb, who were promised at the time the stock was issued that the corporation would repurchase the stock if they wished to sell it, and if financial conditions permitted. The stock of the taxpayer was not listed on any stock exchange (R. 17).

The taxpayer made the following purchases and sales of its own stock during the period from 1931 to 1933, inclusive (R. 18–19):

| 1931 | | | | 1931 | | | |
|---|---|---|---|---|---|---|---|
| Date | Purchases | | Cost | Date | Sales | | Proceeds |
| | Shs. | Price | | | Shs. | Price | |
| Feb. 16 | 60 | 114 | $6,884.00 | Feb. 20 | 25 | 114¾ | $2,869.38 |
| Mar. 30 | 100 | 111¼ | 11,125.00 | Feb. 24 | 35 | 116 | 4,060.85 |
| Apr. 14 | 50 | 111¼ | 5,562.50 | Mar. 31 | 50 | 113 | 5,635.00 |
| Apr. 20 | 100 Cash | 110 | 11,025.00 | Apr. 2 | 10 | 113 | 1,126.60 |
| May 6 | 40 | 103 | 5,412.50 | Apr. 16 | 90 | 111¾ | 10,051.40 |
| Aug. 4 | 100 | 103¾ | 10,100.00 | | 210 shs. | | |
| Aug. 26 | 50 | 96 | 4,810.00 | | | | |
| Aug. 27 | 50 | 96 | 4,810.00 | | | | |
| Sept. 21 | 136 | 96 | 13,063.20 | | | | |
| Sept. 30 | 50 | 96 | 4,810.00 | | | | |
| Oct. 6 | 250 Cash | 98 | 24,500.00 | | | | |
| Oct. 6 | 150 Cash | 98 | 14,700.00 | | | | |
| Oct. 8 | 150 Cash | 98 | 14,700.00 | | | | |
| Oct. 21 | 50 | 98 | 4,910.00 | | | | |
| Oct. 28 | 10 | 98 | 983.05 | | | | |
| Nov. 10 | 350 Cash | 100 | 35,062.50 | | | | |
| Nov. 13 | 50 | 100 | 5,012.50 | | | | |
| Dec. 10 | 25 Cash | 105¾ | 2,600.00 | | | | |
| Dec. 11 | 5 | 102 | 513.00 | | | | |
| | 1,686 shs. | | | | | | |

| | Shares |
|---|---|
| Total Purchases | 1,686 |
| Less Total Sales | 210 |
| Shs. held at end of 1931 | 1,476 |

| 1932 | | | | 1932 | | | |
|---|---|---|---|---|---|---|---|
| Date | Purchases | | Cost | Date | Sales | | Proceeds |
| | Shs. | Price | | | Shs. | Price | |
| Feb. 29 | 146 | 105½ | $15,439.00 | Jan. 12 | 10 | 105¾ | $1,064.10 |
| May 11 | 34 | 105¼ | 2,532.00 | Dec. 7 | 200 | 118.98 | 23,728.00 |
| May 19 | 450 | 102 | 46,012.50 | | | | |
| June 21 | 10 | 108 | 1,063.00 | | | | |
| July 5 | 10 | 108 | 1,063.00 | | | | |
| | 640 shs. | | | | | | |

| | Shares |
|---|---|
| Total Purchases | 640 |
| Less Total Sales | 210 |
| | 430 |
| Balance at end of 1931 | 1,476 |
| Plus purchases in 1932 | 640 |
| | 2,116 |
| Less sales in 1932 | 210 |
| Balance at end of 1932 | 1,906 |

| 1933 | | | | 1933 | | | |
|---|---|---|---|---|---|---|---|
| Date | Purchases | | Cost | Date | Sales | | Proceeds |
| | Shs. | Price | | | Shs. | Price | |
| | | | | Feb. 23 | 20 | 117 | $2,333.20 |
| | | | | May 3 | 5 | 122 | 656.55 |
| | | | | May 5 | 25 | 133½ | 3,329.60 |
| | | | | May [illegible] | 50 | 133½ | 6,665.00 |
| | | | | May 9 | 40 | 134 | 5,346.60 |
| | | | | May 11 | 25 | 131¾ | 3,288.38 |
| | | | | May 15 | 25 | 131 | 3,266.50 |
| | | | | May 22 | 40 | 129 | 5,146.40 |
| | | | | June 9 | 10 | 142 | 1,416.10 |
| | | | | June 9 | 50 | 142 | 7,083.00 |
| | | | | June 9 | 25 | 144 | 3,591.50 |
| | | | | July 12 | 50 | 146 | 7,283.00 |
| | | | | Aug. 31 | 65 | 146 | 9,457.90 |
| | | | | Sept. 1 | 3 | 146¾ | 436.98 |
| | | | | Sept. 6 | 2 | 145½ | 287.82 |
| | | | | Sept. 18 | 10 | 150¼ | 1,498.60 |
| | | | | Sept. [illegible] | 100 | 145 | 14,466.00 |
| | | | | Oct. 25 | 4 | 147 | 584.64 |
| | | | | Nov. 21 | 86 | 146 | 12,536.78 |
| | | | | Dec. 4 | 17 | 143 | 2,425.22 |
| | | | | Dec. 19 | 10 | 150½ | 1,501.10 |
| | | | | Shs. Sold | 662 | | |

| | Shares |
|---|---|
| Balance at end of 1932 | 1,006 |
| Less Sales in 1933 | 662 |
| Balance at end of 1933 | 1,344 |

The taxpayer, during 1933, sold 662 shares of its own capital stock at a total selling price of $92,593.05. The Commissioner, in determining the deficiencies asserted, determined that these 662 shares of stock sold by the taxpayer during 1933 for $92,593.05 were acquired by the taxpayer during 1931 at a cost of $64,648.40 and accordingly added to income the difference of $27,944.65. The taxpayer admits that it did purchase 662 shares of its own capital stock in 1931 and sold the same number of shares in 1933 for the sums above mentioned.

The purchases and sales of the stock were made on the basis of liquidating value, plus or minus a marginal difference to take care of inaccuracies (R. 20).

When the taxpayer purchased the shares of its own stock they were charged to an account designated "Treasury Stock" in the amounts paid therefor, and they were carried as such on the liability side as a deduction from issued capital. Upon subsequent sales of shares of the stock this account was credited with the cost of the respective shares sold, and the excess of the amount received upon the sale of shares over the price at which an equal number of shares were purchased was credited to an account designated "Surplus From Sale of Treasury Stock" (R. 20).

No adjustment was made in the outstanding capital stock by reason of such purchases and sales, the matter being handled entirely by an increase or decrease in the treasury stock. Purchases of stock or securities other than shares of its own capital stock were carried in separate accounts designated "Speculative Long Position in Market" and "Investment Long Position in Market" (R. 20).

The Board determined that the taxpayer realized income in the amount of $27,944.65 from the sales of its stock in 1933, and accordingly assessed a deficiency of $3,909.21 in income tax and of $1,421.54 in excess profits tax (R. 23). The Circuit Court of Appeals affirmed the decision of the Board, holding that the gain derived by the tax-

payer from trading in its own stock during the taxable year represented taxable income in accordance with the provisions of the statute and the amended regulation (R. 33–35).

## SUMMARY OF ARGUMENT

1. For the reasons stated in the Government's brief in *Helvering* v. *R. J. Reynolds Tobacco Co.*, No. 328, present term, the dealings by petitioner in its own shares gave rise to income in the amount of the difference between the cost of the shares to it and the proceeds on sale; and there is no reason to deny application to Regulations 77, Article 66, as amended in 1934.

2. Petitioner's transactions in its own stock were dealings in its shares within the scope of the Regulations as amended. Both the Board and the court below so determined. The purchases and sales were extensive in relation to the number of issued shares, and there was no alteration in the capital structure of petitioner.

3. Gain was realized in 1933, when the shares were sold, not in 1931 when they were purchased for less than their issuing price. Until the sales there was no closed transaction. The analogy to the redemption of bonds at a discount is not apposite.

4. The result contended for by the Government does not produce absurd consequences. The result is simply to tax gains or allow a deduction for losses when realized. Petitioner's view, on the

other hand, would open the door to tax evasion by use of a corporation's own stock in lieu of cash or other property.

## ARGUMENT

### I

### THE DEALINGS BY PETITIONER IN ITS OWN SHARES PRODUCED INCOME UNDER SECTION 22 (A) OF THE REVENUE ACT OF 1932. ARTICLE 66 OF REGULATIONS 77, AS AMENDED IN 1934, TREATS THE GAIN ON SUCH TRANSACTIONS AS INCOME AND THERE IS NO REASON TO DENY APPLICATION TO THE REGULATIONS AS AMENDED

Petitioner, which was organized in 1930 for the purpose of speculating in listed stock, had an authorized capital of 10,000 shares, of which 5,748 were issued (R. 16, 17). The original subscribers, 60 or 70 in number, were promised that the corporation would repurchase their stock "if they wished to sell it, and if financial conditions permitted" (R. 17). The stock was not listed on any exchange (*ibid.*).

During 1931, 1932, and 1933 petitioner made purchases and sales of its shares which were extensive in comparison with its outstanding stock. The purchases and sales were made at approximately the liquidating value of the shares (R. 20). In 1931 petitioner purchased 1,686 shares and sold 210; in 1932 it purchased 640 shares and sold 210; in 1933 it thus had on hand 1,906 shares previously purchased. Of these it sold, in 1933, 662 shares,

the proceeds exceeding the cost of the shares to it by $27,944.65. It is this amount that the Commissioner, the Board of Tax Appeals and the court below determined to be includible in petitioner's income for 1933.

The basic questions involved are discussed in the Government's brief in *Helvering* v. *R. J. Reynolds Tobacco Co.*, No. 328, to be argued immediately preceding the present case. We have there sought to show that gains derived by a corporation from the purchase and sale of its own shares are properly included within the statutory and constitutional concept of income, and that there is no reason to deny application to the Regulations, as amended in 1934, which provide that a corporation realizes gain or loss when it deals in its own shares as it might in the shares of another corporation. The arguments in support of these propositions will not be repeated here, but reference to them in our brief in No. 328 is respectfully made.

## II

### PETITIONER'S TRANSACTIONS IN ITS OWN STOCK WERE WITHIN THE SCOPE OF THE REGULATIONS AS AMENDED

The contention is advanced by petitioner that its transactions in its own shares were not dealings in its own stock, and hence not within the scope of the amended Regulations (Pet. Br. 14–18). The pertinent portion of Article 66 of Regulations 77, as amended by T. D. 4430, *infra*, p. 20, reads as follows:

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another.

It will be observed that the Regulations contrast two kinds of transactions: the issuance of new stock to subscribers, and the dealing in a corporation's own shares as it might in the shares of another. In the present case the stock was bought and sold by petitioner as it might buy and sell any unlisted shares. No change was made in the capital structure of petitioner. The gain on sales was carried on its books as "surplus from sale of Treasury stock." These were not isolated transactions. The relative number of shares dealt in is impressive. The purchases in 1931 and 1932 ag-

gregated more than 40 per cent of the petitioner's issued stock, and the number of shares sold in 1933 exceeded one-ninth of the issued stock. These facts, it is submitted, indicate clearly that petitioner was dealing in its own shares.

It is of no significance that the purchases of shares by petitioner were made pursuant to an informal agreement to do so if a shareholder requested and if financial conditions permitted. The decisive fact is that in buying and selling its shares the corporate structure was not changed. Petitioner apparently had no intention to, and admittedly did not, reduce its capital stock when it purchased the shares or increase its capital stock when it sold the shares. The circumstances that only purchases of its own shares would satisfy the antecedent agreement with stockholders may explain the decision to purchase the shares, but does not alter the conclusion that the corporation in buying and selling was dealing in its shares. A corporation with heavy investments in the shares of another corporation may decide to support the stock of that other corporation by purchases; only that stock will satisfy this purpose, and yet the dealings in it would not take on a unique character for that reason.

The Board and the court below determined that the petitioner was dealing in its own stock as it might in the shares of another corporation. The Board stated that this was the sole issue in the case

(R. 16). The Board stated also that the question presented under the applicable statute and Regulations is whether the taxpayer is dealing in its own shares as it might in the shares of another corporation, that the taxpayer denies that it was so dealing, and that the Board is of opinion that the position of the taxpayer is untenable (R. 21). The petitioner, in its assignment of errors in the court below, asserted that there was no evidence to support the holding of the Board that the petitioner was dealing in its own shares of stock (R. 26). The court below said (R. 34) that "corporations do so deal in their own stocks by buying and selling as they buy and sell other property, and this corporation did that very thing here."

## III

### THE GAIN WAS NOT REALIZED AND TAXABLE IN 1931, THE YEAR OF PURCHASE

It is contended also by petitioner that if any gain or loss was derived by it from its transactions in its own shares, the gain or loss arose in 1931 when petitioner purchased the stock (Pet. Br. 18–20). This contention, it is submitted, is without merit.

In 1931 the shares here in question were purchased by petitioner, but were neither retired nor sold in that year. If they had been retired, there would have been a change in the capital structure, and under traditional practice in the taxation of corporations the increment from the purchase of

the shares at less than their issuing price would be treated merely as gain to the remaining stockholders, not yet realized, however, by them. But where the stock is not retired, the transaction is not closed until the stock is sold, and the gain is then realized by and taxable to the corporate entity itself, since the number and nature of the shareholding accounts is precisely the same after the sale as they were before the purchase, while the cash in the hands of the corporation has been increased by the transactions.

The analogy sought to be drawn by petitioner to the case of *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, is not apposite. That case held that a corporation buying in its bonds at less than the issuing price realizes income in the amount of the difference. Capital stock, though carried on the liability side of the ledger, is not, like bonds, a debt of the corporation. *Eyster* v. *Centennial Board of Finance*, 94 U. S. 500, 502. In the case of the purchase by a corporation of its stock there is no discharge of a fixed obligation. Where the stock is bought with the object of resale rather than retirement the analogy is even more remote. In such a situation, which obtains in the present case, the ordinary principle is applicable that gain is realized upon sale rather than upon purchase. The Treasury has not sought to tax as income the difference between the issuing price and the repurchase price of shares.

## IV

### THE PETITIONER'S VIEW, AND NOT THE GOVERNMENT'S, LEADS TO ANOMALOUS RESULTS

It is finally contended by petitioner that "absurd results" would follow if the Government's contentions were adopted (Pet. Br. 20–21). The hypothetical cases put by petitioner do not reveal any absurdities. The first two cases suggested involve a sale by the corporation of its own shares where between the purchase and sale the value of the shares has been increased or decreased by capital contributions or distributions. The controlling fact in such cases is that gain or loss, as the case may be, is realized by the corporation upon the sale of the shares; it is unimportant whether the gain or loss attributable to the enhanced or diminished value of the shares may be ascribed to capital contributions or distributions, or to some other events in the operations of the business. It is not the increase or decrease in capital which is recognized for tax purposes, but the gain or loss derived in a realizing transaction. Under petitioner's theory, it would be absurd to tax a stockholder on a cash dividend where his net wealth consisting of dividends plus his interest in the assets of the corporation is no greater on receipt of the dividend than his interest in the assets was theretofore. Yet it is settled that dividends are taxable without regard to such circumstances. *United States* v. *Phellis*, 257 U. S. 156, 171.

The cases next suggested by petitioner are those in which a corporation would be taxed on its ordinary earnings and also on the gain from the sale of its own shares, the value of which had been enhanced by those earnings; and, conversely, the cases of two deductions for losses. There is nothing unusual in those situations. Again the controlling fact is that there have been two realizing transactions during the taxable year. The situation is not different from the case of an individual who derives gains from the earnings of his business during the year, on which he is taxed, and who sells the business during the same year at a consequent profit, on which he is also taxed.

The final case suggested by petitioner is that of a corporation selling treasury shares at a loss in order to create a deduction for tax purposes. And it is suggested that a corporation could avoid a gain on the sale of its treasury stock by amending its charter and recapitalizing. It should not be an argument against the Commissioner's position that it will redound to the benefit of taxpayers as well as to the benefit of the Government. Moreover, if the corporation does amend its charter its treatment of its own shares is substantially different than if it buys and sells them without regard to the requirements and limitations imposed by statute and charter on the retirement of shares and the issuance of new shares.

In fact, it is petitioner's position that leads to anomalous results. A corporation whose shares have a ready market could take advantage of a rising market without liability for income tax by choosing to buy and sell its own shares rather than the shares of another readily marketable stock. There would also be opened up an apparent opportunity for tax evasion in connection with the discharge of corporate obligations. Consider, for example, the case of a corporation having an opportunity to discharge an indebtedness of $1,000 for $900. If cash or property is used to do so, gain will result to the corporation in the amount of $100, under the rule in the *Kirby* case, *supra*. But under petitioner's theory, it would presumably be open to the corporation to buy its own shares at $900 and use them to discharge the liability without having to report the difference as taxable gain. Indeed, if the corporation had purchased shares of its own at less than their present value, the gain on the discharge of the obligation by use of those shares would be even greater, and yet no taxable income whatever would result under the theory of petitioner.

The possibility of using a corporation's own shares to defeat tax liability was a factor in the decision in *Commissioner of Internal Revenue* v. *S. A. Woods Machine Co.*, 57 F. (2d) 635 (C.

C. A. 1st). Its own stock was taken by the corporation in settlement of a decree for patent infringement. The court pointed out that the transaction should be considered for tax purposes just as if the corporation received cash instead of its own stock. The court said (p. 636):

> The transaction involved in this case was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. The transaction was not changed in its essential character by the fact that, as the debtor happened also to own the stock, the money payment and the purchase of stock were bypassed, and the stock was directly transferred in payment of the debt. The stock was the medium in which the debt was paid. The wide door to evasion of taxes opened by the decision of the Board is an additional reason, and a weighty one, against it.

It is submitted that whether stock is taken by the corporation in discharge of an obligation to it, or used by the corporation to discharge an obligation owed by it, or bought and sold for cash, the realities of the situation require that the transaction be treated in the same way as where the shares of another corporation are employed.

CONCLUSION

For the foregoing reasons the judgment of the court below should be affirmed.

Respectfully submitted.

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DECEMBER 1938.

# APPENDIX

## STATUTE AND OTHER AUTHORITIES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 605. RETROACTIVE REGULATIONS.
>
> Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:
>
> "SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect". (U. S. C., Title 26, Sec. 1691.)

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * * *

Treasury Regulations 77, relating to the Revenue Act of 1932:

> ART. 66. *Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

Treasury Decision 4430, approved May 2, 1934, XIII–1 Cumulative Bulletin 36:

> ARTICLE 66: Sale by corporation of its capital stock. — XIII–20–6792 T. D. 4430
>
> (Also Section 23 (i), Article 176.)
>
> INCOME TAX
>
> Acquisition or disposition by a corporation of its own capital stock.
>
> Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
*Washington, D. C.*

*To Collectors of Internal Revenue and Others Concerned:*

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, and articles 66 of Regulations 74, approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction

where permitted by the provisions of applicable statutes.

Articles 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

As to the acquisition or disposition by a corporation of its own capital stock, see article 543.

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

As to the acquisition or disposition by a corporation of its own capital stock, see article 66.

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

As to the acquisition or disposition by a corporation of its own capital stock, see article 66.

GUY T. HELVERING,
*Commissioner of Internal Revenue.*

Approved May 2, 1934.

H. MORGENTHAU, Jr.,
*Secretary of the Treasury.*

U. S. GOVERNMENT PRINTING OFFICE: 1934

# SUPREME COURT OF THE UNITED STATES.

No. 385.—October Term, 1938.

First Chrold Corporation, Petitioner,
*vs.*
Commissioner of Internal Revenue.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[January 30, 1939.]

Mr. Justice Roberts delivered the opinion of the Court.

This case presents the same question as that involved in No. 328, decided this day. Certiorari was granted because of a conflict in the decisions below. The statutory provision under which this case arises is Section 22(a) of the Revenue Act of 1932, which is the same as the corresponding section of the Revenue Act of 1928. The regulations, original and amended, have the same relation to this controversy as to that in No. 328. The Board of Tax Appeals sustained a determination of a deficiency in the petitioner's tax for the calendar year 1933 and the Circuit Court of Appeals affirmed the Board's ruling.[1]

For the reasons given in No. 328 the judgment must be

*Reversed.*

A true copy.

Test:

*Clerk, Supreme Court, U. S.*

[1] 97 F. (2d) 22.